S. HRG. 102–964

COMPETITION IN THE AIRLINE INDUSTRY AND S. 2312, THE AIRLINE COMPETITION ENHANCEMENT ACT OF 1992

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

SECOND SESSION

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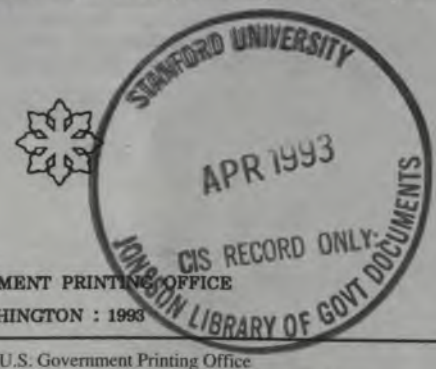

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COMPETITION IN THE AIRLINE INDUSTRY AND S. 2312, THE AIRLINE COMPETITION ENHANCEMENT ACT OF 1992

WEDNESDAY, JUNE 10, 1992

U.S. SENATE,
SUBCOMMITTEE ON AVIATION OF THE
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m, in room SR–253, Russell Senate Office Building, Hon. Wendell H. Ford (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Carol J. Carmody, professional staff member, and Samuel E. Whitehorn, senior counsel; and Bill Hughes, minority professional staff member.

OPENING STATEMENT OF SENATOR FORD

Senator FORD. I want to welcome all the crowd. I wish this was a political meeting for John McCain and Wendell Ford this morning. We would have an overflow crowd.

Good morning, ladies and gentlemen. I have called this hearing today to examine some of the ways airlines are competing with each other and to hear testimony on Senator McCain's bill, S. 2312, the Airline Competition Enhancement Act.

From what I saw the first few days of June, no one in America is willing to drive anywhere this summer. They were all standing in line buying tickets to fly some place. Airfares during the 10-day sale were so low that people bought first and made plans later, it appears.

I guess in terms of volume the sale was a success. I am always glad to see competition and good prices for the consumer, but I cannot help wonder how an industry which is struggling to stay alive can afford a price war like this one.

Some industry observers have charged that the low fares are part of a plan by some carriers to drive others out of business, and I would like to examine those charges this morning. We have three airlines here today who can talk about that, and I am looking forward to it.

We will also hear testimony about provisions of S. 2312, Senator McCain's bill, which deals primarily with computer reservation systems or CRS. We have had a number of hearings on this subject in the past. Each time the Department of Transportation has said they are looking on a rulemaking, so legislation is not necessary. In the meantime, the CRS industry has evolved and many of the

abuses or complaints raised about CRS a few years ago have been corrected.

In the past, we have had legislation before the committee which would require divestiture of the systems. Now this latest legislation speaks of ending of all bias in the system. I am still not sure that legislation is warranted, but I do believe it would be useful for the Department to complete its regulations.

I do not buy the excuse that the administration's regulatory moratorium has delayed the CRS rules. These rules were overdue long before the moratorium took effect. Besides, I expect the moratorium is selective and does not apply to those very few areas where the administration may wish to regulate.

Another area where the Department has failed to act time after time is the area of slots. My bill in 1990 directed DOT to undertake rulemaking to provide access for new entrant carriers. There has been no final rule issued as of June 1992. This is another situation where legislation might not be necessary if the Department would fulfill its role and regulate in this area.

We have a number of very distinguished witnesses this morning, so I would like to get started. I hope that their testimony will help us first understand what is happening in the industry, and then decide if there is a role for legislation. Mr. Chairman, if you please.

OPENING STATEMENT OF SENATOR HOLLINGS

The CHAIRMAN. Good morning. The hearing today will focus on competition within the airline industry and S. 2312, the Airline Competition Enhancement Act.

We are holding this hearing at a time when the aviation industry continues to be in a state of flux, raising concerns about the future of this industry. Last year, more than 450 million people used the air transportation system. Unfortunately, however, with the recession and the Persian Gulf war, traffic was not as high as expected. We know that the carriers lost about $6 billion over the last 2 years. We have seen Pan Am, Eastern, and Midway close down, and Continental, TWA, and America West all are operating under the protection of the bankruptcy laws. With these facts in mind, the future of competition in the airline industry is unclear.

It is in this context that we must review carefully the legislative proposals before us today. Certain witnesses will testify that legislation to regulate computer reservation systems—CRS's—is absolutely necessary. These CRS's are now regulated by a set of rules established by the Civil Aeronautics Board in 1984. Those rules also had a termination date, unless extended by the Department of Transportation. Since 1989, DOT has issued an advance notice of proposed rulemaking and a notice of proposed rulemaking. It also has extended the rules three times, the latest extension occurring last month. Finalization of the rules is subject to the presidentially mandated regulatory moratorium. I will be interested to hear DOT's response to concerns that these rules have not been made final in the more than 2 years that DOT has been analyzing the issue.

Witnesses today also will testify that the latest fare war that just ended last week constituted predatory pricing and behavior that further aggravates the anticompetitive trend in the airline indus-

try. I know that this is a highly controversial matter, and one that is now the subject of lawsuits in Texas and Illinois. I look forward to the discussion today on issues critical to the future of the aviation industry.

Thank you, Mr. Chairman.

Senator FORD. Thank you, Mr. Chairman. We are very pleased to have my ranking member here with us this morning, Senator McCain. Senator McCain.

OPENING STATEMENT OF SENATOR McCAIN

Senator MCCAIN. Thank you very much, Mr. Chairman, and I greatly appreciate at this very busy time your convening this hearing today, and I am greatly appreciative of the efforts that you have made personally to try and ensure that we have true competition in the airline industry.

We are clearly at the critical juncture in determining whether any semblance of true competition will survive in the domestic airline industry in the United States. The past 6 weeks have brought us to a new crisis stage of commercial aviation in the United States. I am profoundly concerned that what we are witnessing is not simply a new round of fare wars but a determined and thinly disguised effort to bring about the final round of concentration in the industry.

An aviation industry dominated by a few powerful carriers is definitely not in the interests of the American public, and it should not be accepted as a natural result of market forces by this subcommittee, the Congress, the administration, and certainly not the American people.

The accelerating pace of concentration demands that the Congress take a decisive leadership role to enact a series of specific and eminently justifiable measures to eliminate anticompetitive forces in the industry, particularly given the fact, as we will see today, that the administration refuses time after time to act, now hiding behind the thin disguise of the regulatory moratorium.

Almost 15 years ago, the Airline Deregulation Act spoke, too, about explicitly about protecting the public's interest by preventing, "unfair, deceptive, predatory, or anticompetitive practices in air transportation and the avoidance of unreasonable industry concentration."

Mr. Chairman, there is a chart up there that was recently printed in one of the newspapers that shows the concentration in the industry. In 1978 you will see others had 39 percent of the air traffic in America. That increased in the true period of blooming of airline deregulation up to 41 percent, and we have seen a steady decline now that the so-called others are at 12.3 percent.

You will hear in Mr. Shane's statement this morning that the administration obviously views this as a fait accompli, because he talks about the "big three," time after time in his statement when the fact is, Mr. Chairman, in 1978 and 1985 there was no big three in this country. There was a number of competitive airlines, and unfortunately the names like Pan American, Eastern, Air Cal, Air Florida—the list goes on and on of distinguished names of airlines that truly provided competition in this country—are no longer there.

We need only to look at the disturbing path the airline industry has taken since 1985 to be forewarned. Just 7 years ago, 10 airlines accounted for 80 percent of the U.S. market. Today, five airlines control the same share of the market and further delay and inaction will definitely make things worse.

I enjoy being able to purchase lower cost airline tickets, and I welcome steps by domestic carriers to simplify their fare structures and offer big savings to consumers. If these overwhelmingly popular steps were the primary results of the recent fare wars, I would be content today to focus solely on the need to reform computer reservation systems and expand the use of commuter slots at high density airports.

I have another chart to put up, Mr. Chairman, that shows what has happened to the airline industry, and this is taken from another national media. The chart is of the not so profitable skies, showing that every airline in America is suffering enormous losses. As much, according to the statistics, as $6.5 billion since 1991 have been lost by the airline industry. Clearly, no industry can survive with those kinds of losses, but those with the deepest pockets will probably survive.

Cutrate ticket prices are a welcome bargain for travelers, but their value will become a bitter memory if predatory pricing strategies enable the industry leaders to effectively become the industry controllers. We have seen the effects of oligopolies in numerous industries in the United States and they do not bode well for consumers interested in low fares and increased options for air travel.

It is inconceivable to me in the face of volumes of testimony and evidence on the anticompetitive effect of CRS's that the Department of Transportation has been unable to come forward with their final rulemaking on this issue. The GAO, the Department of Justice, independent CRS operators, the American Society of Travel Agents, and the Department of Transportation itself, have attested to the problems with many aspects of carrier-owned computer reservation systems.

I am especially pleased that the American Society of Travel Agents is supportive of S. 2312, and I will not go over the parts of the bill again, Mr. Chairman, in the interests of time.

I also want to mention the need for Congress to increase the opportunities for new and limited incumbent carriers to purchase slots at controlled airports. Access to slots at our Nation's high-density airports is a key factor to ensuring competitive marketplace. This legislation would do so by allowing commuter-designated slots to be converted for large jet services use.

I would like to thank the witnesses and the industry officials who will be testifying today. Mr. Chairman, let me just point out what I think is incredible as to the view of the administration on this issue. Mr. Shane's statement is perhaps the most Orwellian that I have heard in the 10 years that I have been a Member of Congress. I quote from his statement:

> Now that we have a better understanding of just how intensively competitive the airline industry has become, it is not apparent why anyone would realistically expect a large number of new carriers to appear.

Mr. Chairman, it is my view that the reason why we enacted the Airline Deregulation Act was so that new carriers would appear.

Now the administration view is that it is unrealistic for new carriers to appear. I mean, I would suggest to you that the administration's position has been one of obfuscation, delay, and frankly, the consolidation of an industry which betrays the intent and the purpose of deregulation in this country and has led to a recent 2 year's loss of 50,000 jobs of hardworking Americans who would otherwise be gainfully employed.

Mr. Chairman, I will save the rest of my comments for the witnesses. I note that our colleague and friend from Connecticut is here, and appreciate him being here.

Thank you, Mr. Chairman.

Senator FORD. Thank you. Senator Bryan, do you have a statement?

OPENING STATEMENT OF SENATOR BRYAN

Senator BRYAN. Mr. Chairman, in the interests of time, I would like to ask unanimous consent my statement be made a part of the record, and I will be anxiously awaiting the testimony of our distinguished witnesses and our able colleague, who is about to enlighten us.

[The prepared statement of Senator Bryan follows:]

PREPARED STATEMENT OF SENATOR BRYAN

Mr. Chairman, thank you for holding this hearing. The issue of competition in the airline industry is of great importance to the entire nation, but there is nowhere where it is more important to the local economy than my home state of Nevada.

Quite simply, tourism is the lifeblood of Nevada, and the aviation industry is one of the most important factors in the tourist economy.

Nevada offers tourists many attractions, and the tourism industry in Nevada is vibrant and exciting. No matter how great the attractions, however, the industry cannot survive if the visitors cannot get to Nevada, and today, the vast majority of tourists arrive by plane.

As the number of hotel rooms in Nevada continue to increase, particularly in Las Vegas, our dependence on efficient, reasonably priced air travel will also increase. Businesses in Nevada have worked hard, and invested many dollars, throughout the years to develop the type of facilities and infrastructure needed to accommodate an immense number of visitors. In recent years, this investment, combined with other attractive features of our state, has created explosive growth.

The current situation in the airline industry threatens the most important industry in my state. Nevada benefits when its visitors benefit, and its visitors benefit from vigorous competition in the airline industry. My first concern is for the easiest and most efficient service to our airports; my second is that this service will be available at prices people can afford. Both of these are jeopardized by further consolidation of the airline industry.

Events like the recent fare wars worry me. Clearly, there will be some benefit in the tourism industry from the low fares. While its effect on the profits of the airlines has not yet been determined, there is little doubt that the increased travel will prove a money maker for the hotels, car rental companies, and other tourism related industries. However, if the price for a summer of increased tourism proves to be the further decline, or even liquidation, of any of the weaker carriers, I think the tourism industry as a whole will suffer. In the long term, the loss of competition in the airline industry may restrain future growth in the tourism industry.

In an era of deregulation, we cannot protect every carrier. Carriers with poor management, or sometimes just bad luck, will necessarily fail. I have never been a strong supporter of deregulation, but if the industry is to remain deregulated, it is important that the industry be competitive.

If Congress is to act to ensure competitiveness in the airline industry, it must act soon. Unless the industry comes around soon, it is clear that further consolidation will take place, a development which I believe will eventually prove harmful to my state, and the rest of the nation.

I look forward to hearing the testimony of the witnesses.

Senator FORD. Thank you. Senator Kasten.

OPENING STATEMENT OF SENATOR KASTEN

Senator KASTEN. Mr. Chairman, let me just very briefly say that I share the concern and the frustration just expressed by my friend from Arizona, Mr. McCain, and I am pleased that we are taking up once again this subject of aviation competition and in particular the issue of slots, and also the issue of computer reservation systems.

The frustration is in part because when I look at this witness list we have got in many cases exactly the same people, certainly the same organizations, and the same Department of Transportation and the same witness that we have had before us. It is the same cast of characters, if you will, that we have had before and tried to work with in different ways, and yet there has been no definitive action on slots or on the computer reservation system.

Now we have got the President's moratorium as the latest reason for delay, I am told. But we have had delay upon delay upon delay, and all sorts of efforts made to confuse and disrupt the overall effort, so today we are here to look once again at what can be done, to listen to the testimony as to any of the modifications that can get us to a piece of legislation, if in fact that is necessary, that can be enacted.

It has been a long road, it has been a frustrating road, it has been a difficult road. The cosponsorship that many of us have of S. 2312 is the result of that frustration, of that concern that the administration has not been willing to act and to deal, notwithstanding the fact that others—well, that Mr. Shane and others have said before us in the past—they are trying to move toward certain solutions to these kinds of problems, and so I look forward to the testimony, but I also share the concern which has been discussed here today to all the committee members.

Thank you, Mr. Chairman.

Senator FORD. Thank you.

We are delighted to have the distinguished Senator from Connecticut, the former outstanding Attorney General, my friend Senator Lieberman. We would be delighted to have your testimony, Senator.

STATEMENT OF HON. JOSEPH I. LIEBERMAN, U.S. SENATOR FROM CONNECTICUT

Senator LIEBERMAN. Thank you very much, Mr. Chairman and members of the committee, for permitting me to testify this morning on S. 2312, the Airline Competition Enhancement Act of 1992.

I am pleased to be an original cosponsor of this legislation along with the Senator from Arizona, Senator McCain, and Mr. Chairman, I appreciate the mention of my past, because it is probably most importantly from that perspective as a former Attorney General and from the viewpoint of consumer protection that I come to this issue and to this hearing.

I know that it seems strange and in some sense anachronistic to be raising concerns about airline competition at a time when airline price wars bring us the lowest fares that we have seen in years.

As a consumer, of course, I hope that trend continues. Competition is what airline deregulation was supposed to be all about. By lowering fares, competition has over the years enabled probably millions of people who rarely or ever flew to travel on vacations or to see loved ones, and that is the way it ought to be, Mr. Chairman.

When the Governmental Affairs Committee's Consumer and Environment Subcommittee held a hearing on this topic in February we entitled it "Few Airlines, Higher Fares?" Our concern was with the round of closings and mergers in the airline industry, reducing it to basically three strong airlines, with others in some difficulty, as Senator McCain and others have indicated.

Of all the airlines created after deregulation, only one continues to exist, and that one is in bankruptcy. We asked the question about what that meant for consumers—did it mean that competition was declining, so that with the normal working of the marketplace consumers could expect higher fares? Subsequent events since February have clearly demonstrated that fare wars can still happen, but I think we still need to ask ourselves: are these bargain fares competition at work, or are they simply the final throes, the "going-out-of-business" bargains of an industry that is in serious trouble?

The critical question, I think, is can long-term competition, which for consumers means good service and fair prices, be salvaged in the airline industry? Airline deregulation was founded on the premise that the airline industry would always be fully competitive with easy entry into it and exit out of the business. But if competition falters and the airline industry includes only a few airlines in regional monopolies, then I am afraid airline travelers are going to be the big losers and that fares will just continue to go up, up, and away.

S. 2312 is aimed at tackling two problems that have been identified as anticompetitive effects in the airline business. The first, of course, is the computer reservation systems which are used by travel agents to book flights, and the second is the limits on takeoff and landing slots at the four high-density airports.

Mr. Chairman, since we introduced S. 2312, Senator McCain and I have continued to work on it, taking into consideration the comments that we have received from a number of participants in the industry from airlines to travel agents to consumers. Our goal here is not to penalize any specific companies or to favor others, and I want to stress that.

The amendment we filed last week on this bill reflects changes that we think are necessary, and I am very pleased to say the amended bill has now drawn support from across the aviation and travel industry, including not only the CRS providers—other than the two largest, Sabre and Covia—but also airlines such as Delta and Northwest, the two travel associations, ASTA and ARTA, and consumer groups such as the Consumer Federation of America and the Aviation Consumer Action Project. We are very grateful for this broad support and take it as proof that this bill now really is proconsumer and procompetitive.

Mr. Chairman, CRS systems as you well know are a major concern of S. 2312, not just because Senator McCain and I and others

have focused on it, but the Department of Transportation itself stated in March 1991 in its notice of proposed rulemaking that CRS vendors, "have the ability and incentive to use their continuing market power to prejudice airline competitors by raising the competitor's cost and diverting traffic"—and that is the DOT.

The DOT found that each CRS system, "controls access to most of its subscribers and at least the larger systems have a monopoly in certain regional CRS markets."

The Department of Justice has also alleged that each CRS system has a monopoly over access to its subscribers since few agencies use more than one system, and it is the control over a travel agent base that can only be accessed through a particular CRS that gives a CRS operator the ability to adversely affect competition between airlines.

As amended, S. 2312 takes what I think is an important step forward in combating competitive abuse of CRS's, and it does it in a balanced way. The bill requires the CRS operator to eliminate what has been called "architectural" or "functional bias," and I am pleased to say that as I understand it American and Covia have both stated that they do not oppose the principle of equal functionality as a requirement.

However, requiring equal functionality on those computer systems addresses only one-half the problem. Remember what DOT said in its rulemaking process: CRS operators prejudice competitors both by diverting traffic, which is the problem addressed by equal functionality, and by raising costs.

S. 2312, as amended, confronts the issue of raising competitor's costs by allowing arbitration of booking fees. Now, Mr. Chairman, I must say that I am generally reluctant to place limits on pricing in our market system, but in this case I do not see an alternative. That still puts a break on CRS's market power. Arbitration just gives an option to a competing airline that feels that it is being improperly treated in booking fees.

S. 2312, as amended, also attempts to rein in monopoly problems by limiting the CRS operator's control over an airline's access to its subscriber agents. It does this by both placing limits on contractual terms the CRS operator can impose on a travel agent, and by requiring CRS operators to allow the use of third-party equipment to access their systems where technically feasible.

For the most part, we have not really plowed new ground in the proposals in this bill. All the limitations on CRS travel agent contracts, except the provision for liquidated damages, were actually proposed by the Department of Transportation in its March 1991 proposed rules, as were the provisions permitting travel agents to use third-party hardware to access a CRS system.

Mr. Chairman, much of what we propose to accomplish in this legislation in fact could already have been done by DOT if it had the will to complete its rulemaking in a timely manner. Unfortunately, there remains no indication that the Department will do so. Prompt action has not been DOT's hallmark in dealing with the competitive problems caused by the CRS's. I take it that my colleague from Wisconsin would agree with that understatement.

Senator KASTEN. I would agree with that understatement.

Senator LIEBERMAN. Thank you.

DOT first confirmed the existence of this problem in 1988, 4 years ago. It studied and reconfirmed them again in 1990. Its proposed notice of rulemaking in March 1991 again confirmed that competitive problems caused by CRS's still exist. Its conclusions have been buttressed by several GAO studies, by a study in the National Academy of Sciences and by the Department of Justice, so this is not any seat-of- the-pants casual indictment here.

Despite study upon study upon study, DOT has yet again postponed any action on a final rule. When I testified before the Governmental Affairs Committee's Consumer Subcommittee in February, DOT projected that it would complete its CRS rule, the final rule, this summer. Well, Mr. Chairman, I regret to say that that date has again slipped, this time to December of this year, so I believe that we cannot really wait any longer for DOT to act in this area that is very important to American consumers and American business.

Because we rely on air traffic so much, the time has come for Congress to step in and legislate the reforms necessary to rein in the monopoly power of CRS operators and to lower the barriers to new entry and competition in the airline industry. This is really a case of looking beyond the immediate where fare wars are going on to the longer term health of an industry that is vital to the economy of America and vital to the concerns of America.

Mr. Chairman, I urge the committee to move to mark up S. 2312 as it has now been amended, and I thank you again for your interest in this subject and for permitting me to testify this morning.

[The prepared statement of Senator Lieberman follows:]

PREPARED STATEMENT OF SENATOR LIEBERMAN

Mr. Chairman, I thank you and the members of the Committee for permitting me to testify today regarding S. 2312, the Airline Competition Enhancement Act of 1992, of which I am pleased to be an original cosponsor.

It seems almost anachronistic to be raising concerns about airline competition at a time when airline price wars bring us the lowest fares we've seen in years. As a consumer, I hope this intense competition continues. Competition is what airline deregulation was all about. By lowering fares, competition has enabled thousands perhaps millions—of people who rarely or never flew to travel to see loved ones or to vacation anywhere in our country.

When the Governmental Affairs Committee's Consumer and Environmental Affairs Subcommittee held a hearing during February entitled "Fewer Airlines, Kigber Fares?" I was concerned about what the recent round of closings and mergers would mean for consumers. Did this mean that competition was declining so that consumers should expect higher fares? Subsequent events clearly demonstrate that fare wars can still happen, but we need to ask ourselves: "Are these bargain fares competition at work, or are they simply the final throes, the 'going out of business' bargains of an industry in serious trouble?"

The critical question, as I said at the February hearing, is: "Can long-term competition—which for consumers means good service and fair prices—be salvaged in the airline industry?" Airline deregulation itself was founded on the premise that the airline industry would always be fully competitive, with easy entry into, and exit out of, the business. If competition falters, and the airline industry includes only a few airlines in regional monopolies, consumers will be the big losers. Fares will go "up, up and away."

S. 2312 tackles two problems identified as having strong anticompetitive effects: the computer reservation systems used by travel agents to book flights, and limits on takeoff and landing slots at high density airports.

Since we introduced S. 2312, Mr. Chairman, Senator McCain and I have continued to work on it, taking into consideration the comments we received from a number of participants in the industry, from airlines to travel agents to consumers. Our goal here is not to penalize any specific companies or to favor others. The amend-

ment we filed last week reflects the changes we believe are necessary. I am pleased to say that the amended bill has drawn support from across the aviation and travel industry, including not only CRS providers other than the two largest, Sabre and Covia, but also airlines such as Delta and Northwest, the two travel agents' associations, ASTA and ARTA, and consumer groups such as the Consumer Federation of America and the Aviation Consumer Action Project. We are grateful for this broad support—and take it as proof that our bill is really pro-consumer and pro-competition.

CRS systems are a major concern of S. 2312 because, as the Department of Transportation stated in its March 1991, Notice of Proposed Rulemaking, CRS vendors have "the ability and incentive to use their continuing market power to prejudice airline competitors by raising the competitors' costs and diverting traffic." DOT found that each CRS system "controls access to most of its subscribers and that at least the larger systems have a monopoly in certain regional CRS markets."

The Department of Justice has alleged that each CRS system has a monopoly over access to its subscribers, since few agencies use more than one system. It is the control over a travel agent base that can only be accessed through a particular CRS that gives a CRS operator the ability to adversely affect competition between airlines.

As amended, S. 2312 takes an important step forward in combating competitive abuse of CRSs. This bill requires a CRS operator to eliminate what has been called "architectural" or "functional" bias. I am pleased to say that American and Covia have both stated they do not oppose an equal functionality requirement.

Requiring equal functionality, however, only addresses half of the problem. Remember what DOT said in its rulemaking notice: CRS operators prejudiced competitors both by diverting traffic—the problem addressed by equal functionality—and by raising costs. S. 2312, as amended, confronts the issue of raising competitors' costs by allowing arbitration of booking fees. While I am generally reluctant to place any limits on pricing, I see no alternative that still puts a brake on a CRS' market power.

S. 2312, as amended, also attempts to rein in monopoly problems by limiting a CRS operator's control over an airline's access to its subscriber agents. It does this both by placing Hits on the contractual terms a CRS operator can impose on a travel agent to lock the travel agent into a single CRS system, and by requiring CRS operators to allow the use of third party equipment to access their systems, where technically feasible.

For the most part, we have not plowed new ground in these proposals. All the limitations on CRS/Travel Agent contracts, except the provision dealing with liquidated damages, were proposed by the Department of Transportation in its March 1991 proposed rules, as were the provisions permitting travel agents to use third party hardware to access a CRS system.

Mr. Chairman, much of what we propose to accompllsh in this legislation could already have been done by DOT, if it had the will to complete its rulemaking in a timely manner. Unfortunately, there is no indication that the Department will do so. Prempt action has not been DOT's hallmark in dealing with the competitive problems caused by CRSs. DOT first confirmed the Cxistence of these problems in 1988. It studied—and reconfirmed—them again in 1990. Its Notice of Proposed Rulemaking in March 1991 again confirmed that competitive problems caused by CRSs still exist. Its conclusions have been buttressed by several GAO studies, by a study by the National Academy of Sciences, and by the Department of Justice.

Despite study upon study upon study, DOT has yet again postponed any action on a final rule. When it testified before the Consumer Subcommittee of the Governmental Affairs Committee, DOT projected it would complete its final CR5 rule this summer. That date has slipped yet again to December.

Mr. Chairman, I believe we can no longer wait for DOT to act. The time has come for Congress to step in and legislate the reforms necessary to rein in the monopoly power of CRS operators and to lower the barriers to new entry and competition in the airline industry. I urge the Committee to move to markup S. 2312, as amended.

Senator FORD. Thank you very much, Senator Lieberman. Does anyone have any questions of the Senator?

Senator MCCAIN. I would just like to thank Senator Lieberman, and particularly note the perspective that he brings to this issue from his past experience as an attorney general, and being heavily involved in consumer issues. He mentioned that the subject of the hearing that he had was, will fewer airlines mean higher fares? I

wonder if maybe now it would be Darwinism in the sky kills airlines. That seems to be what it has evolved into. But I am especially appreciative of the insight that he brings to this issue, and appreciate very much all of his efforts. I thank you, Mr. Chairman.

Senator LIEBERMAN. I thank my colleague.

Senator FORD. Does anyone have any questions of the Senator?

[No response.]

Senator FORD. Thank you, Senator Lieberman. We have been joined by two other Members. Senator Stevens, do you have an opening statement you would like to make?

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Mr. Chairman, I had a nice, long, opening statement.

Senator FORD. We will put it in the record.

Senator STEVENS. I will summarize by saying, I do not think anyone has the same interest in this hearing that Alaskans do. We have one-fifth the size of the United States. We have 12,000 miles of roads. I have got reported a 6-month loss for our major carrier, and the other carrier has declared bankruptcy. And I was told yesterday that all of the airlines that serve Alaska are in danger of following the same, and having the same impact as far as their financial difficulties.

I cannot tell you how much I support this bill. The only thing is, I hope that in the process of this hearing, we will decide to go further. I do not think the bill goes far enough, and I will develop that later. Thank you.

[The prepared statement of Senator Stevens follows:]

PREPARED STATEMENT OF SENATOR STEVENS

Mr. Chairman, while I agree in principle with the thrust of S. 2312, the Airline Competition Enhancement Act of 1992, I do not believe that this legislation goes far enough.

In my State, Alaska, air transportation is vital to our survival. Alaska has one-fifth of the land mass of the entire United States, yet we have only 12,000 miles of roads. Because we have so few roads, over 70 percent of Alaska's communities can only be reached by air.

Rural America has a unique dependence on aviation, for deliveries of mail and even food. It is crucial that regional carriers be kept viable.

But even the regional carriers are now in trouble. Our major regional carrier, Alaska Airlines, has reported record losses for the first 6 months of this year. In addition, on Tuesday of this week, Alaska's Markair declared bankruptcy. This could have a profound impact on service in our State—and on the cost of essential air service to the Federal Government.

And just yesterday, I was told that an airline analyst predicts the failure of three of the airlines serving Alaska now.

I believe the current situation cannot be allowed to continue. Issues like predatory pricing and the transfer of assets in bankruptcy—like the sale of Pan Am's Los Angeles-Mexico City route to United—must be addressed for their anticompetitive impacts.

There is one other issue of particular importance to Alaska which I believe needs to be addressed. Just a few weeks ago, Delta announced its decision to stop service to Juneau during the nonsummer months. Delta is not alone—a number of Lower 48 carriers only fly to Alaska during the peak summer months, leaving Alaska Airlines and Markair to provide service during the lean winter months. This situation is not fair to Alaskans, and it is not fair to Alaska's airlines.

Unfortunately, the Office of the Assistant Secretary for Policy and International Affairs at the Department of Transportation is unable to resolve these issues because that office has been assigned conflicting tasks. Internationally, the office is responsible for representing America's major air carriers in international negotia-

tions. Domestically, the office is supposed to ignore its commitment to those major carriers and establish policy that is best for all domestic carriers.

I believe that these two goals are contradictory, and ultimately stifle the Assistant Secretary's ability to act. I would like to see the responsibilities of that office divided between two officials—one to work on international policy and the other to work on domestic policy. Then perhaps, some of these concerns could finally begin to be addressed.

As I have said, I believe this is an outstanding bill—but I think it can be made even better. I look forward to working with Senators Ford and McCain to ensure passage of legislation which truly meets the needs of America's ailing airline industry.

Senator FORD. We have been joined by the distinguished ranking member of the full committee. Senator Danforth, do you have a statement?

OPENING STATEMENT OF SENATOR DANFORTH

Senator DANFORTH. Mr. Chairman, thank you very much. It is not possible to live in my State or to represent my State without spending a lot of time on TWA. And it is not possible to fly on TWA without being asked by every airline pilot and flight attendant I see about the future of that airline. I do not know what the future of that airline is. I know that it is hanging on now, I guess, for dear life. And this is clearly an emergency situation.

We have been suggesting legislation now for several years, and it is time for Congress to try to do something, I think, with respect to this present, dismal situation in the airline industry.

Senator FORD. Thank you. The second witness this morning, then, is Jeffrey Shane, Assistant Secretary for Policy and International Affairs, Department of Transportation.

STATEMENT OF JEFFREY N. SHANE, ASSISTANT SECRETARY OF TRANSPORTATION FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION

Mr. SHANE. Thank you very much, Mr. Chairman. Yes, I have listened with enormous interest to the opening statements, and I guess all I can say to Senator Kasten is that nobody wishes more than I that you had a different DOT witness this morning, Senator.

Mr. Chairman, it is always a privilege to appear before this subcommittee, and it is a privilege this morning to comment on provisions of S. 2312, and the state of competition in the airline industry today. I have a longer, prepared statement which I would ask your permission to insert in the record, and I would ask permission to summarize that statement.

Senator FORD. Without objection. I was reading your statement here—a couple of items that have been highlighted. And I was so intrigued that I forgot to—it is the same thing I read last time. [Laughter.]

Mr. SHANE. The airline industry, Mr. Chairman, is facing challenges unlike anything we have witnessed since the early days of deregulation. The industry's recent history, to be sure, is characterized by a lot of bad news. But a lot of good news has essentially gone unnoticed. Even with fewer airlines than we had a few years ago, the level of competition has not declined, and airfares continue to be a bargain. Even before the widely publicized fare wars that began in April, inflation-adjusted domestic airfares had continued

their long-term downward trend, and for the year ending December 31, 1991, were at their lowest level ever.

But, most importantly, we are now seeing clear evidence of new pressures that will assure the continued competitiveness of the industry in the future. While I understand your concerns and those of other Members, I believe the information I will present this morning will illustrate why the Department strongly opposes S. 2312, and why regulatory and not legislative action is more appropriate to the issues facing the airlines and their customers today.

There is good reason to think that the U.S. airline industry is not going to have its prices set at noncompetitive levels. Moreover, the evidence suggests that the big three airlines—and, yes, there can be no denying that we do have a big three—may find it difficult, regardless of their size, to increase their relative positions in the face of pressures by growing, smaller airlines, particularly low-cost airlines. The large airlines will have to reduce costs if they are to continue to grow and prosper in the domestic market. The end result will be continued good service for the traveling public at highly competitive prices.

The ongoing debate about the competitiveness of the airline industry has changed direction a couple of times in recent years, and I believe the debate is about to take still another, fundamental turn. But, once again, we think it is a positive one. I believe that few would dispute that the airline industry is, in fact, very competitive today, but the debate has now shifted to whether the industry will remain competitive.

That concern hinges on the assumption that the big three have such a competitive advantage that they will have the ability to weed out rivals. In fact, as the deregulation process continues to evolve, it is beginning to become clear that the big three airlines are not in a position to dictate the future of the domestic air transportation system.

First, we should remember that in spite of all the consolidation that has occurred, we still have nine major passenger airlines. That is to say, major passenger airlines with revenues of over $1 billion each per year. That is important, because the key to increasing competitiveness in recent years has been the expansion of the airlines' networks. The remaining nine major carriers will continue to expand. While one or more airlines may fail, we can reasonably expect most to succeed, giving us one reason to conclude that the industry will remain competitive.

A second source of future competition is the growth of low-cost, point-to-point service. Southwest Airlines is the prime example of this powerful new competitive force. Southwest is now, by far, the fastest growing domestic airline, and is also the lowest cost airline by a wide margin, except for America West, whose costs are comparable.

Wherever Southwest operates, it charges such low fares that other carriers, including the big three, have to follow suit. Wherever they compete it is Southwest, not one or more of the big three, that regularly sets the price. Today, Southwest sets the price in markets that account for, in the aggregate, over 20 percent of our domestic passenger trips. It currently serves California, the Southwest region of the country, and is now expanding in the Midwest.

I am not suggesting to you that the survival of the larger airlines is threatened by Southwest, or that Southwest Airlines alone will provide all of the competitive discipline the industry needs in the future. But I am suggesting that as a consequence of low-cost, point-to-point service, the big three are not in the position to dominate domestic markets. Rather, they must find a remedy to their serious disadvantage in operating costs.

In addition to low-cost carriers like Southwest and America West, a number of smaller carriers are quietly developing their own operating systems. For example, Alaska Airlines is rapidly growing, and will soon be large enough to be classified as the 10th major airline. Even smaller successful airlines such as Midwest Express are gradually, but consistently, building a competitive presence.

In relative terms, Midwest Express is still a very small airline, but its service has rapidly expanded over the past 3 to 4 years. Alaska Airlines, Midwest Express, and Southwest all have dispelled the idea that only the big airlines can earn profits in this market. These three airlines have been among our most profitable for several years now.

Another component of competition in the future which cannot be dismissed is new entry. Today, the notion of new entry is almost automatically rejected out of hand by many industry observers. We are all fully aware of the lack of significant new entry into the domestic airline system in recent years, and this is often regarded as a failure of deregulation. I think, however, it is more a testament—and this is the Orwellian passage to which Senator McCain referred—to the very high degree of competitiveness in the deregulated industry.

Now that we have a better understanding of just how intensely competitive the airline industry has become, it is not apparent why anyone would realistically expect a large number of new carriers to appear. The point, Senator McCain, is that it is just not an easy industry to make money in. And that is a deterrent to the new entry that we would have otherwise expected.

But new entry is not dead. I can tell you that at the Department of Transportation, we see applications for new entry into this business on an almost weekly basis. New firms are regularly submitting plans to start new, small airlines. Many never start up, but others do. Some are commuter carriers. Some are charter carriers. Some are in the cargo business. And some are small, scheduled passenger airlines. Based on our experience over the past few years and this year, I believe this constant flow of new entry will continue. These new carriers are constantly seeking niches where the current industry structure can be exploited. We see that happening today by existing carriers, and once the restructuring process runs its course, if indeed that ever happens, then the pace of new entry will almost certainly pick up. From time to time, some of these new airlines will find a niche that they can use as a springboard to establishing a truly meaningful, competitive presence.

The established airlines have acknowledged these growing sources of competition and are not acting as they would if the industry were indeed headed toward oligopoly. The trade press is rife

with announcements of long-range, cost-cutting campaigns by all airlines, including the big three.

These cost reduction efforts signal recognition of new competitive pressures, but they also represent an acknowledgement by the airlines that fares must be kept low if the demand for domestic air travel is to continue to grow. I think that the airlines will find ways to keep their costs down, to keep traffic growing, and to return to profitability.

Mr. Chairman, my prepared testimony shows statistics which are relevant to all of this discussion. I will just quickly summarize those. First, the number of markets in this country continued to increase in 1991, despite the effects of the recession and the demise of Eastern Airlines at the beginning of 1991. That is to say, it is important not to think of this country as a single market, but as a collection of markets—20,000 city-pair markets, in fact. That number has increased. It has increased since 1988 by 2,600 markets, and it has gone up by 9,400 markets since 1984.

Second, intense competition is moving into even smaller markets. During 1991, the average density of markets with the most intense competition, that is to say, markets with five or more competitors, was less than 100 passengers a day. Years ago, you would have had to have many, many more passengers than that in a city-pair market in order to support five competitors.

Third, the number of markets in 1991 with three or more competitors continues to be higher than in 1988, and is more than 2½ times the number that we had in 1984.

Finally, fare premiums at connecting hubs show virtually no change from 1988 to 1991, that is to say, about 19 percent. And the proportion of total passengers that are affected by those fare premiums remains the same; that is to say, about 5 percent of total passengers in the U.S. domestic market.

Turning to financial performance, certainly it has been a bleak period for the airline industry during the past 2 years. But while the industry has a long way to go to return to an acceptable level of profitability, we are confident that it will succeed. Certainly, a weakened economy has affected the profitability of the airline industry, but I do not think the committee should overlook another important effect, and that is the increasing globalization of the U.S. airline industry today.

Globalizing a route system is a very expensive process involving both enormous startup costs and always operating losses as newly acquired routes are developed and marketed. That process, which is an important feature of what the airline industry is doing today, has clearly had a disproportionately downward influence on profits, but that is an influence that will not be repeated beyond the near term.

I am encouraged that all three airlines that are now in bankruptcy showed considerable improvement in the first quarter, compared with the previous quarter. And two of those carriers were virtually at operating break-even during the first quarter of this year. Industry earnings beyond the first quarter of 1992, of course, are very uncertain. That uncertainty stems from the very broad-based revisions to airline pricing that occurred in early April, when American Airlines introduced a simplified fare structure.

Whether American's new fare structure will produce more revenue for the industry is difficult now to evaluate. American has indicated that it did not believe that average fares would change very much, but that more people would fly. Business travel, in particular, would be stimulated as these travelers could make flexible arrangements at more reasonable prices.

The only results we have to date show that for April, domestic yields were 8.5 percent higher than in April 1991, offsetting a 5.3-percent decline in traffic, thereby producing a 2.8-percent increase in revenue. The April yields were also slightly higher than this year's March yields. That limited evidence may suggest that the new fare structure did, indeed, attract additional business travel and more revenue to the market. But that news, of course, is now stale because of a series of fare wars starting in late April, and continuing into late May, when American cut its lowest discount fares in half.

While those lower fares will certainly cause yields to decline, we cannot know how much revenue will be lost because nobody knows what proportion of their seats particular airlines committed to the lower fares. All indications are that whatever capacity the airlines decided to offer at those low fares was quickly sold out. And whatever the ultimate impact for now, the airlines quickly pulled in additional revenue for travel that will be occurring over the course of the summer.

Now, please let me turn to S. 2312, and address the computer reservations systems issues, first. Airline computer reservation systems—CRS's—are an indispensable means by which travel agents make bookings and receive information on schedules, fares, and seat availability. In 1984, the Civil Aeronautics Board, supported by the Department of Justice, found that certain airlines were using their control over CRS to handicap airline rivals. The CAB adopted rules that have been in effect and enforced by the Department of Transportation with only slight modifications ever since.

Although the current rules have been effective in dealing with certain problems, there have been calls for more regulation. Controversy has persisted over practices that were deliberately left unregulated, and others that have come to be seen by some parties as new impediments to airline competition. The Department has looked at the evolution of the CRS industry over several years, publishing a major study in 1988, and another report in 1990.

On March 26, 1991, we issued a notice of proposed rulemaking that proposes several modifications to the present rules, and that requested comment on other proposals. The rules had been scheduled to expire on December 31, 1990, but they have been extended until December 11, 1992, to give us more time to complete that rulemaking.

Mr. Chairman, given the ongoing nature of the Department's rulemaking, I am sure you will understand that I cannot comment in detail on those provisions in S. 2312 that deal with CRS. As a matter of policy, however, the Department strongly opposes a legislative response to CRS regulatory issues. The CRS industry continues to evolve, both in terms of technology and market structure. The development of hostless CRS's and the improving communication linkages between CRS vendors and participating airlines are

already working to reduce any unfair competitive advantages that may result solely from CRS ownership.

The CRS industry, moreover, is becoming truly global, and the U.S. vendors are establishing joint ventures and marketing agreements with foreign air carriers. Premature legislative action to correct currently perceived problems could result in additional costs and reduced service for subscribers, participating airlines, and CRS vendors with few, if any, offsetting benefits for consumers.

Turning to the slot provisions of S. 2312, section 2 would allow an airline with fewer that 12 air carrier slots at a high-density airport to use commuter slots to provide service with large jet aircraft.

Mr. Chairman, as you know, the Department is now considering more efficient methods of allocating existing capacity at all high-density airports to improve competitive opportunities for new entrants. We initiated a rulemaking, pursuant to the Aviation Safety and Capacity Expansion Act of 1990, to consider that issue. A supplemental NPRM concerning slot allocation and transfer methods at high-density traffic airports was published on September 13, 1991.

Another approach to the use of commuter slots for large aircraft operations is a rule published by the FAA last August, applicable specifically to O'Hare International in Chicago. Under that rule, as adopted, the FAA will permit a limited number of commuter slots at O'Hare to be used by jet aircraft having a maximum seating capacity of up to 110 passenger seats.

The FAA will limit the number of commuter slots available for operation of such aircraft to 25 percent of each operator's commuter slots at O'Hare, and limit the number of such operations in any half hour period. The rule will remain in effect for a 2-year period to allow the FAA to evaluate the effect of the change on the operation of the airport and the air traffic facilities.

I believe that these kinds of approaches are better ways than mandated legislation of trying to provide additional opportunities for new entrant airlines or small incumbent carriers to obtain slots from commuter airlines or others.

Finally, Section 4 of S. 2312 would add language to Section 419 of the Federal Aviation Act to prevent the Department from considering slot availability in setting EAS—essential air service—guarantees. It would also require the Department to ensure sufficient slots are available to the carrier providing, or selected to provide such service. However, slots would not have to be made available at O'Hare if the number of available EAS slots is at least 132.

Finally, the section would amend current law to clarify that an air carrier suspending service to an EAS community could not keep slots associated with the service unless they were being used to provide basic, essential service to another EAS community.

Slots at O'Hare are a scarce resource and should be used in an efficient manner to benefit all communities. When sufficient access to the national transportation system can be provided through other regional airports, allocating additional slots at O'Hare to EAS communities near Chicago may not be, in our view, a wise use of these scarce resources. The Department is not in a position to create new commuter slots and, as I stated in my comments on section 2 of the bill, we recently published a final rule concerning the oper-

ation of jet aircraft in commuter slots at O'Hare, and we prefer a rulemaking approach rather than a mandated legislative solution to the slot problem.

I will stop there, Mr. Chairman. And I would be delighted to entertain your questions and those of your colleagues.

[The prepared statement of Mr. Shane follows:]

PREPARED STATEMENT OF JEFFREY N. SHANE

Mr. Chairman and members of the subcommittee, I am pleased to have this opportunity to appear before you to comment on the provisions of S. 2312 and the state of the competition in the airline industry.

The airline industry is facing challenges unlike anything we have witnesses since the early days of deregulation. The industry's recent history is characterized by a lot of bad news: The industry's loss of six billion dollars during 1990 and 1991; the failure of three large airlines last year; and the continuing bankruptcy status of three more for airlines. Not surprisingly, some fear that industry consolidation will continue to the point that effective competition will be lost.

But a lot of good news has essentially gone unnoticed even with fewer airlines than we had a few years ago, the level of competition has not declined and air fares continue to be a bargain. Even before the widely publicized fare wars that began in april, inflation adjusted domestic air fares had continued their long-term downward trend and for the year ending December 31, 1991, were at their lowest level ever. But most importantly, we are now seeing clear evidence of new competitive pressures that will assure the continued competitiveness of the industry into the future. While I understand your concerns, I believe information I will discuss today will illustrate why the Department strongly opposes S. 2312 and why regulatory, not legislative, action is most appropriate for the issues facing the airlines and their customers.

We have been telling you that the domestic airline system remains very competitive, and I am going to repeat that message today using up-to-date information to demonstrate the point. I will also briefly talk about the industry's financial condition, and, as you have requested, I will offer my views on the provisions of S. 2312. But my focus today will be primarily on the future of competition in domestic aviation.

There is good reason to believe that the U.S. airline industry is not going to have its prices set at noncompetitive levels. Moreover, the evidence suggests that the "big three" airlines may find it difficult to increase their relative positions in the face of pressure by growing, smaller airlines, particularly low-cost airlines. The large airlines will have to reduce costs if they are to continue to grow and prosper in the domestic market. The end result will be continued good service for the traveling public at highly competitive prices.

The ongoing debate about the competitiveness of the airline industry has changed direction a couple of times in recent years and I believe that the debate is about to take still another fundamental turn—once again a positive one.

In the mid-1980's, at a time when a large number of airlines ceased to operate as separate entities, including most airlines that came into being as a result of deregulation, concerns arose about the competitiveness of the industry. These concerns led former Secretary Skinner to create a task force to conduct a comprehensive assessment of the state of airline competition. That study, concluded in early 1990, showed unequivocally that the industry had not only remained competitive, but had actually become more competitive during the very time that the number of carriers had declined through merger or failure. This increased competitiveness is a direct consequence of the trend competing hub-and-spoke networks made possible by deregulation. This structural change virtually guarantees active competition even with fewer airlines. The National Academy of Sciences and the Brookings Institution have also thoroughly studied the competitiveness of the airline industry and reached conclusions virtually identical to our own.

I believe that few would dispute that the airline industry is, in fact, very competitive today. But the debate has now shifted to the industry will remain competitive. This concern hinges on the assumption that the big three airlines have such a competitive advantage that they have the ability to continue to weed out rivals. In fact, as the deregulation process continues to evolve, it is beginning to become clear that the big three airlines are not in a position to dictate the future of the domestic air transportation system.

First, we should remember that in spite of all the consolidation that has occurred, we still have nine passenger airlines (revenues over $1 billion annually). this is im-

portant because the key to increasing competitiveness in recent years has been the expansion of the airlines' networks. We know that the hub-and-spoke dominated structure strongly encourages geographic expansion; each new spoke that is added to a hub multiplies the number of markets that airline serves. The remaining nine major carriers, therefore, will continue their efforts to expand, and each of them, particularly airlines other than the big three, have room to expand extensively in domestic markets. In tandem, these elements—a significant number of airlines with room to expand and a built-in incentive to do so—will provide for intense competition from within. While one or more airlines may fail, we can reasonably expect most of these airlines to succeed, giving us one reason to conclude that the industry will remain competitive.

A second source of competition is the growth of low cost point-to-point service. The larger airlines all have a very significant cost disadvantage compared with some smaller airlines, and they simply cannot effectively compete in the long term with airlines that have operating costs that are 25 percent or more below their own. Southwest Airlines is the prime example of this powerful new competitive force. Until very recently Southwest was essentially a Dallas Love Field niche carrier. It is now by far the fastest growing domestic airline and is also the lowest cost airline by a wide margin except for America West, whose costs are comparable. Wherever Southwest operates it charges such low fares that other carriers, including the big three, must follow suit. Wherever they compete, Southwest—not one or more of the big three airlines—regularly sets the price. Today, Southwest sets the price in markets that account for over 20 percent of domestic passenger trips. It currently serves California, the Southwest region of the country, and is now expanding in the Midwest. This is a very important shift in the competitive balance in domestic air service. One out of every five domestic passengers pays a price that is well below what any other airline would otherwise charge as a consequence of the competitive presence of this single, low cost airline.

I am not suggesting to you that the survival of the larger airlines is threatened by Southwest, or that Southwest Airlines alone will provide all the competitive discipline the industry needs in the future. But I am suggesting that as a consequence of low cost point-to-point service the big three airlines are not in a position to dominate domestic markets. Rather, they must find a remedy to their serious disadvantage in operating costs. This is a major issue for the large airlines to deal with, and I believe is leading us into still another phase of the airline deregulation process.

In addition to low cost carriers like Southwest and America West, a number of smaller carriers are quietly developing their operating systems. For example, Alaska Airlines is rapidly growing, primarily by expanding its service in the contiguous 48 states, and will soon be large enough to be classified as the tenth major airline. Even smaller successful airlines such as Midwest Express are gradually, but consistently, building a competitive presence. in relative terms, Midwest Express is still a very small airline, but its service has rapidly expanded over the past three to four years. Alaska Airlines, Midwest Express and Southwest all dispel the idea that only the big airlines can earn profits. These three airlines have been long the most profitable for several years now.

Another component of competition in the future which cannot be dismissed is new entry. Today, the notion of new entry is almost automatically rejected out of hand by many industry observers. We are all fully aware op the lack of significant new entry into the domestic airline system in recent years, and this is often regarded as a failure of deregulation. I believe, however, that this is more a testament to the very high degree op competitiveness in the deregulated airline industry. Now that we have a better understanding of just how intensely competitive the airline industry has become, it is not apparent why anyone would realistically expect a large number of new carriers to appear.

However, new entry is not dead. I can tell you that we at the Department see applications for new entry into this business on an almost weekly basis. New firms are regularly submitting plans to start new, small airlines. Many never start up, but others do. Some are commuter carriers, some are charter airlines, some are cargo airlines, and some are small, scheduled passenger airlines. Based on our experience over the past few years and this year, I believe this constant flow of new entry will continue. These new carriers are constantly seeking niches where the current industry structure can be exploited. We see that happening today by existing carriers, and once the restructuring process runs its course, if indeed that ever happens, then the pace of new entry will almost certainly pick up. From time to time some of these new airlines will find a niche that they can use as a springboard to establishing meaningful competitive presences.

The established airlines see these growing sources of competition and are not acting as they would if the industry were headed toward oligopoly. The trade press is

rife with airline announcements of long range cost cutting campaigns, not just by the financially struggling carriers, but by all airlines including the big three. These efforts at cost reduction are indicative of the reality the domestic industry faces—vigorous competition far into the future. These cost reduction efforts signal recognition of new competitive pressures. But, they also represent an acknowledgment by the airlines that fares must be kept low if the demand for domestic air travel is to continue to grow. They must keep air travel competitive with surface travel and substitutes for air travel such as teleconferencing. I believe that the airlines will find ways to keep their costs down, keep traffic growing, and to profitability.

As I promised at the outset, I will present a few statistics for 1991 that show the industry indeed remains very competitive. First, the number of markets continued to increase in 1991 despite the effects of the recession and the demise of Eastern Airlines at the beginning of 1991. There are now over 20,000 markets, up by 2600 since 1988, by which time the first round of industry consolidation had run its course, and up by 9,400 markets over 1984, before the process of consolidation had started. This shows that the relentless competitive dynamics of hub-and-spoke networks continue to link more and more small cities into the mainstream of air travel.

Second, intense competition is moving into even smaller markets. Hubbing virtually dictates that airlines compete for even very small volumes of traffic. During 1991, the average density of markets with the most intense competition—five or more competitors—was less than 100 passengers a day. This average size is half what it was in 1988. Traffic volumes that small could not have supported a satisfactory pattern of operation for even a single airline in the point-to-point systems of service that were operated before deregulation. In 1979, there were only three markets with five or more competitors; today there are 120. Moreover, in 1979 the average daily volume in five-carrier markets was 10 times greater than today, or almost 1,000 daily passengers.

Third, the number of markets in 1991 with three or more competitors continues to be higher than in 1988, and is more than two and a half times the number in 1984. Traffic in these markets, measured by passenger miles, is 40 percent higher than in 1984, and only four percent below 1988 despite the effects of the recession. The percentage of total traffic in these markets has consistently been about 50 percent of total traffic, although literally thousands of very small markets have been developed since 1984 and even since 1988, as I have described.

Fourth, an area of concern that we had identified in our competition study is fare premiums in short-haul markets at connecting hub complexes that are dominated by a single carrier. Our study was based on 1988 data, and we have now updated our hub premium calculations using data through 1991. The new data show virtually no change in the fare premium, at about 19 percent. Nor has there been any change in the proportion of total passengers that are affected, about five percent. This is considered very good news because of concern that as hubbing practices matured, hubbing carriers might be able to tighten their grip on the respective connecting hubs and extract even greater premiums from additional passengers. That's not happening.

These comparisons all show that competition remains as intense as ever, notwithstanding the consolidation that has occurred since the mid-1980's.

Turning to financial performance, it has indeed been a bleak period for the airline industry during the past two years. But while the industry has a long way to go to return to an acceptable level of profitability, we are confident that it will succeed.

Of great importance in my opinion is the fact that the losses have not resulted from a fundamental failure attributable to industry structure, but are the result of a set of circumstances, the most telling of which have been beyond the industry's control. You know, of course, that I am referring to the Persian Gulf war and the economic downturn. Either event alone would have hit industry earnings hard. The airlines are a very cyclical industry and one of the most sensitive industries to fluctuations in the business cycle. And the war had a staggering effect on both costs and passenger demand in international operations. But in tandem, these events were much more difficult to deal with. The war led to enormous losses that severely depleted financial reserves and the ability of all airlines to deal with the economic downturn. The fact that the industry has managed to cope with these circumstances as well as it has is an indication of its overall resilience.

The more recent disappointing performance of the industry to some extent reflects the weak economy, but it has also been strongly influenced by the globalization process.

Several airlines are greatly expanding their international operations through entry on new routes and acquisitions of routes and other assets of failed carriers and carriers that elected to withdraw from certain international markets. This is a very expensive process, involving enormous startup costs and operating losses, as

newly acquired routes are developed and marketed. This process clearly has had a downward influence on profits that will not be repeated beyond the near term. Also important, from the standpoint of industry consolidation, these costs are generally being borne by the largest, strongest airlines and not those in weakened financial condition. In fact, I am encouraged that all three airlines now in bankruptcy show considerable improvement in the first quarter compared with the previous quarter, and two of these carriers are virtually at operating breakeven.

Industry earnings beyond the first quarter of 1992 are very uncertain. The economy has shown signs of recovery, which should boost traffic and revenues, and, ultimately, profitability. But the uncertainty stems from very broad-based revisions to airline pricing that occurred in early April when American Airlines introduced a simplified fare structure.

Whether American's new fare structure will produce more revenue for the industry is more difficult to evaluate. American has indicated that it did not believe that average fares would change very much but more people would fly. Business travel in particular would be stimulated as these travelers could make flexible arrangements at more reasonable prices. American's assessment was not shared by all. Industry analysts generally held the view that American's new fares would cause average fares and revenue to drop.

The only results we have to date show that for April domestic yields were 8.5 percent higher than last April, offsetting a 5.3 percent decline in traffic to produce a 2.8 percent increase in revenue. The April yields were also slightly higher than March yields. This limited evidence may suggest that the new fare structure attracted additional business travel. And actullly increased average fares.

However, this news is now stale because of a series of fare wars starting in late April and continuing into late May, when American cut its lowest discount fares in half. But while these lower fares will almost certainly cause yields to decline, we cannot be sure how much will be lost because no one knows what proportion of their capacity particular airlines will commit to the lower fares. All indications are that whatever capacity the airlines have decided to offer at these low fares was quickly sold out. Whatever the ultimate impact, for now, the airlines quickly pulled in additional revenue for travel that will be occurring over the course of the summer.

Turning to S. 2312, let me first address the computer reservations systems issues.

Airline computer reservation systems (CRSs) are an indispensable means by which travel agents make bookings and receive information on schedules, fares, and seat availability. In 1984, the Civil Aeronautics Board (CAB), supported by the Department of Justice, found that certain airlines were using their control over CRSs to handicap airline rivals. The CAB adopted rules that have been in effect and enforced by the Department of Transportation, with only slight modifications, ever since.

Although the current rules have been effective in dealing with certain problems, there have been calls for more regulation. Controversy has persisted over practices that were deliberately left unregulated and others that have come to be seen by some parties as impediments to airline competition.

The Dopartment has studied the evolution of the CRS industry over several years, publishing a major study in 1988 and another report in 1990. On March 26, 1991, we issued a notice of proposed rulemaking (NPRM) that proposed several modifications to the present rules and requested comment on other proposals. The rules were scheduled to expire on December 31, 1990, but have been extended until December 11, 1992, to give us more time to complete our rulemaking.

Mr. Chairman, given the ongoing nature of the Department's rulemaking, I'm sure you will understand that I cannot comment in detail on those provisions in S. 2312 that deal with CRSs. As a matter of policy, however, the Department strongly opposes a legislative "solution" to CRS regulatory issues. The CRS industry continues to evolve, both in terms of technology and market structure. The development of "hostless" CRSs and the improving communication linkages between CRS vendors and participating airlines are working to reduce any unfair competitive advantages that may result solely from CRS ownership. The CRS industry, moreover, is becoming truly global, and U.S. vendors are establishing joint ventures and marketing agreements with foreign air carriers. Premature legislative action to correct currently perceived problems could result in additional costs and reduced service for subscribers, participating airlines, and CRS vendors with few, if any, offsetting benefits for consumers.

Calls for additional CRS regulation have focused on four issues: The level of booking fees paid by participating airlines, biased displays, contract provisions that prevent subscribers from more easily switching CRSs, and the perceived advantages CRS vendor airlines enjoy over other airlines because agents believe it is easier and safer (i.e., more reliable) to make a booking on the vendor airline.

BOOKING FEES

The proposed legislation would require that fees charged to participating airlines be "fair and reasonable." Disputes would be submitted to the decision of an arbitrator. Vendors would then be prohibited for a period of one year from charging fees greater than those found "FAIR AND REASONABLE."

The Department proposes to continue prohibiting discriminatory booking fees. In our NPRM, however, we did not call for additional regulation of booking fees.

We did indicate that we were willing to consider such a rule if it were workable, would provide significant net benefits to society, and would rely on market forces.

Quite frankly, arbitration is not a workable solution to the booking fee problem; indeed, arbitration suffers from many of the problems of traditional public utility regulation. Measuring and allocating the vendors' legitimate costs and determining a competitive rate of return are difficult tasks under the best of circumstances, much less in a risky and technologically progressive industry. There also would be no guarantee that the outcomes of successive arbitration proceedings would be mutually consistent or that the implications of these decisions for the CRS industry's long-term competitive viability would be considered. In short, arbitration could weaken rather than improve competition in the CRS industry, and the department strongly opposes this provision.

DISPLAY BIAS

Under S. 2312 CRS vendors would be prohibited from offering integrated displays ordered by carrier identity. In addition, the bill would prohibit a vendor from inducing a subscriber to create a biased, integrated display. Vendors would also be prohibited from supplying information to any person intending to create a biased, integrated display, except upon written request of the ultimate customer.

Under the current rules vendors are prohibited from ordering a primary display based on air carrier identity. The vendors, moreover, have voluntarily agreed to forgo offering biased, secondary displays. We do not believe that vendors should be required to "police" how travel agencies use CRS information to serve their customers.

CONTRACTS WITH TRAVEL AGENTS

The proposed legislation would relax the contractual relationships that the travel agents subscribing to a CRS to the vendor. It would restrict subscription contracts with travel agents to a maximum term of three years (compared with the present limit of five years). Exclusive contracts, parity with other systems, minimum-use requirements, automatic renewal, and overlapping terms with other contracts between the same parties would be prohibited. Liquidated damages for breach of contract would be restricted to the actual costs of removing equipment and other sums that would have been payable by the subscriber if the contract had remained in force. The right of a subscriber to connect to the CRS hardware, software, and data bases supplied by third parties would be guaranteed.

The Department has addressed many of these concerns in its NPRM by proposing to extend the present ban on exclusive contracts, proposing a maximum three-year subscription term, prohibiting minimum-use clauses, and proposing to permit access to multiple systems via cohmon equipment. The parties' comments on these proposals differ on such rules are desirable, and we are examining their positions in the rulemaking process. We believe that these issues are appropriately addressed by regulation, not legislation.

ARCHITECTURAL BIAS

The bill would eliminate alleged architectural bias by requiring that after one year no transaction capability would be offered to any subscriber or participant airline that is "* * * more functional, timely, complete, accurate, reliable, secure, or efficient with respect to one participant than with respect to any other participant."

The concept of "equal functionality" could have merit as a competitive ideal, but in practice its precise definition, technical feasibility, cost, potential benefits, and monitoring are all highly speculative and uncertain. We believe that a rulemaking proceeding in which evidence can de submitted and these issues resolved is a more appropriate forum than legislation.

Turning to the slot provisions of S. 2312, section 2 would allow an airline with fewer than 12 air carrier slots at a high density airport to use commuter slots to provide service with large jet aircraft. Mr. Chairman, as you know, the Department is now considering more efficient methods of allocating existing capacity at all high density airports to improve competitive opportunities for new entrants. We initiated

a rulemaking, pursuant to the Aviation Safety and Capacity Expansion Act of 1990, to consider this issue. A supplemental NPRM concerning slot allocation and transfer methods at high density traffic airports was published on september 13, 1991.

The amendments we proposed are intended to promote access to high density airports by carriers that do not now serve these airports or that have limited operations at one or more of the airports.

Another approach to consider the use of commuter slots for large aircraft operations is a rule published by the FAA last August. Under the rule as adopted, the FAA will permit a limited number of commuter slots at O'Hare to be used by aircraft having a maximum seating capacity of up to 110 passenger seats. The FAA will limit the number of commuter slots available for operation of such aircraft to 25 percent of each operator's commuter slots at O'Hare, and limit the number of such operations in any half-hour period. The rule will remain in effect for a two-year period to allow the FAA to evaluate the effect of the change on the operation of the airport and air traffic facilities.

Once some adjustment of the current mix of commuter and air carrier operations is determined to be feasible from an operational standpoint, and not to have an unacceptable impact on small community air service, the Department will be in a position to consider further rulemaking in this area.

I believe that these kinds of approaches are better ways than mandated legislation of trying to provide additional opportunities for new entrant airlines or small incumbent carriers to obtain slots from commuter airlines or others.

Finally, section 4 of S. 2312 would add language to section 419 of the Federal Aviation Act to prevent the Department from considering slot availability in setting EAS guarantees. It would also require the Department to ensure sufficient slots are available to the carrier providing, or selected to provide, such service. (However, slots would not have to be made available at O'Hare if the number of available EAS slots is at least 132.) Finally, this section would amend current law to clarify that an air carrier suspending service to an EAS community could not keep slots associated with the service unless they were being used to provide basic essential service to another EAS community.

Slots at O'Hare are a scarce resource and should be used in an efficient manner to benefit all communities. When sufficient access to the national transportation system can be provided through other regional airports, allocating additional slots at O'Hare to EAS communities near Chicago is not, in our view, a wise use of these scarce resources. The Department is not in a position to create new commuter slots and, as I stated in my comments on section 2 of the bill, we recently published a final rule concerning the operation of jet aircraft in commuter slots at O'Hare, and we prefer our rulemaking approach rather than a mandated legislative solution to the slot problem.

Senator FORD. Mr. Shane, you said we had nine major air carriers and you rated those based on income, and each of those nine had better than a billion of income; is that correct?

Mr. SHANE. In revenues, yes, sir.

Senator FORD. Did you include TWA, America West, and Continental in the big nine?

Mr. SHANE. I believe so. I would like to clarify that for the record, if I am wrong.

Senator FORD. Well, all three of those are in at least chapter 11; are they not?

Mr. SHANE. Yes, sir.

Senator FORD. They are not in trouble, are they?

Mr. SHANE. I am just talking about the definition of a major air carrier.

Senator FORD. Well, you attribute the industry's hard times to the economic downturn and the Gulf War and everything else you can think of, but you left out one word, I think, and that is called debt. Would you agree that air carriers who pile on excessive debt, whether it is for aircraft routes or a buy-out, make themselves vulnerable to any changes in the market?

Mr. SHANE. There is no question but that increasing an air carrier's debt certainly makes it more vulnerable to the cyclical trends

that the airlines are always vulnerable to, yes. Yes, Mr. Chairman, I agree with that. Whether it is a good or bad decision to take on debt at a particular moment in an airline's financial history is a complicated decision.

Senator FORD. Do you mean complicated on the one hand if they had done that, or on the other hand if they had done that it would have been different?

Mr. SHANE. Well, I am saying that in certain circumstances, without taking on a certain measure of debt at a certain moment in an airline's history, it may have meant the demise of that airline right then, so taking on debt may have in fact prolonged the life and the prospects for future prosperity of that company.

Senator FORD. Mr. Shane, has the Department of Transportation collected any data that would indicate booking fees being charged by CRS owners to the airlines are unreasonable?

Mr. SHANE. No, sir. We do not have data that would show that the fees are unreasonable, and I am not even sure that I would know precisely how to identify an unreasonable fee on the basis of any criteria that I could imagine putting together.

Senator FORD. Do you know or could you supply for the record the range of booking fees among the four CRS owners?

Mr. SHANE. I believe we can certainly supply that for the record.

Senator FORD. I would like to have that, please, sir.

[The information referred to follows:]

The CRS vendors offer three basic levels of participation to airlines, as well as optional "direct/total access" premium participation. The subscribing airline selects the level of participation and is charged accordingly when a booking is made. There are four CRS vendors in the United States (Sabre, Covia/Apollo, Worldspan, and System One). Three of the vendors have adopted a similar, but not identical, fee structure, charging for each confirmed segment booked in a passenger's itinerary. Covia/Apollo has adopted a different pricing structure based on the number of transactions.

The lowest level of service is a display of airline schedule and fares; no seat availability, reservation, or confirmation information is supplied. Also, under this level of service, bookings are not made through the CRS (the agent must contact the airline directly). For this level of service, Worldspan and System One charge airlines $1.15 per segment. Sabre charges $1.13 per segment.

For a fee of $1.65 on System One, $1.75 on Worldspan, and $1.77 on Sabre, air carriers can participate in a higher level of service where bookings are made through the CRS, although still no information on seat availability is displayed.

For a higher fee, airlines can have a booking made through the CRS and have information displayed on seat availability. This level of service is often referred to as full, standard, or basic participation. Most air carriers participate in this level of service, and Sabre, Worldspan, and System One charge $2.15 per segment booked.

In addition to full availability, the CRS vendors also offer airlines the option of participating in direct/total access, which links the vendor's CRS to an airline's internal reservation system, thus allowing subscribers to interact with that airline's internal reservation system on a real-time basis. This level of participation provides travel agents with the most accurate information on an airline's fares and seat availability. The additional charge for this higher level of participation is $0.25 per booking on Worldspan and $0.28 per booking on Sabre and System One. The total cost of this level of service for these three vendors is thus $2.40 to $2.43 per segment booked in the United States.

Covia/Apollo has a distinct fare structure, charging for both data input and cancellation. The basic booking fee for a reservation made through Covia/Apollo's fee for the highest level of service it offers (Inside Link) is $1.30 per confirmed segment.

Covia/Apollo, however, also charges a cancellation fee of $0.20 per booking; therefore, the total booking fee could be higher or lower than that charged by the other vendors depending on how many times the reservation is altered.

Senator FORD. Would you say the CRS industry is very different than it was in the early 1980's when the CAB first imposed the rules?

Mr. SHANE. I believe so. It is a matter of degree, but surely the very fact that a Congress has been looking very hard at allegations of anticompetitiveness in the CRS industry, the fact that the Department of Transportation has proposed rules, all of these signals have been taken seriously within the CRS industry, No. 1, and I believe you are beginning to see some responses; responses to those signals and responses to demands from travel agents, so that indeed I think you are seeing a movement toward equal functionality, for example, even without a requirement to do so.

You are seeing a movement in the case of Worldspan toward a hostless system for the first time. You are seeing a globalization of the CRS industry with a multiplicity of U.S. and foreign carriers getting together to become the hosts of the systems. A great many changes are taking place, and it is precisely for that reason that we think that legislation is the wrong way to go. Legislation, by its very nature, cannot move as quickly as this very, very fast-moving, highly technology-driven industry can.

Senator FORD. Do you believe that the rules have corrected any of the suggested abuses in the CRS arena?

Mr. SHANE. To be sure. When the CAB got into the business of regulating computer reservation systems the principal concern was what we call display bias. There was probably some architectural bias as well, which is more hardware specific, but the display bias problem was an obvious problem which simply meant that when a travel agent called up a display of flights, the host carrier put its own flights in the most prominent position. That surely was anticompetitive, and so the rules now absolutely prohibit display bias of that kind.

Senator FORD. How do you assess the carrier's recent behavior in the 10-day fare war?

Mr. SHANE. Well, they are responding, it seems to me, in the way one would expect to competitive challenges, if I understand the thrust of the question. I do not know whether it is appropriate for me to second-guess airline management and how they would respond to the challenge of lower fares being offered by their competitors.

Senator FORD. Well, you ultimately make decisions as it relates to the carriers. Why not go ahead and tell us what you think about this.

Mr. SHANE. Well, we tried to get ourselves out of the business of judging whether or not their fares made any sense in 1978, and I think that was a good decision.

There really is not any function for the Department of Transportation on the question of fares left in the Federal Aviation Act beyond, I believe, one section of the act which remains—section 411—which says that if indeed a practice rises to the level of being an unfair competitive practice, it would be appropriate for the Government to look into that and possibly to take steps to cause those practices to cease and desist.

We have not had any petition to that effect. We certainly have not, on the basis of anything that is in the Department right now, seen reason to invoke that provision.

Senator FORD. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

I want to repeat again, Mr. Shane, your statement is perhaps the most Orwellian that I have heard in 10 years and has the least touch with reality of anything I have ever heard. Let me give you a small example:

> We are now seeing clear evidence of new competitive pressures that will assure the continued competitiveness of the industry into the future. The ongoing debate about the competitiveness of the airline industry has changed direction a couple of times in recent years.
>
> I believe the debate is about to take still another fundamental turn, once again a positive one. In fact, as the deregulation process continues to evolve, it is beginning to become clear that the big three airlines are not in a position to dictate the future of the domestic air transportation system.

I wonder what just happened in the last 10 days?

Let us go to page 16 of your statement, please.

> Mr. Chairman, given the ongoing nature of the Department's rulemaking, I am sure you will understand that I cannot comment in detail on those provisions in S. 2312 that deal with CRS's.

Given the ongoing nature—that is one part of your statement I agree with you, Mr. Shane. Ongoing nature is absolutely correct.

In 1988 and 1990, the Department of Transportation produced studies documenting the problems with CRS's. In March 1991, the Department of Transportation issued proposed CRS rules. The date for issuing a final CRS rule has been officially delayed three times and is now postponed until December 1992.

In both 1988 and 1990, Congress passed legislation calling for a rulemaking to increase slot access for new entrants. On February 19, 1991, then Secretary Skinner promised—I repeat, promised this committee that a slot rule would be issued by early in the second quarter of 1991.

In September 1991, one day before a Commerce Committee hearing, the Department of Transportation issued a proposed slot rule.

Last month, you told this committee that the slot rule was indefinitely postponed due to the President's regulatory moratorium, and yet page 21 of your statement says: "We believe that a rulemaking proceeding in which evidence can be submitted and these issues resolved is a more appropriate forum than legislation."

Mr. Shane, how in the world does that make any sense? For 4 years now, we have been talking about a rulemaking. The Secretary of Transportation promised this committee over a year ago that we would have a rulemaking forthcoming, and now, because of the President's laudable effort to stop regulations, you are now using that as a rationale for not having a rulemaking. Yet in your statement before this committee you are saying the rulemaking is a better method to pursue. How does that make any sense, Mr. Shane?

Mr. SHANE. Well, you heard my colloquy with the chairman, Senator McCain. I said that this is a highly technology-driven industry. I have dealt with this industry over a great many years. I have negotiated on behalf of the CRS vendors with foreign countries. What I know is that if you establish legislation, establish rules on

the basis of what the industry looks like in 1992, you will have a mistake on the books by 1993.

It has been a long process. I am not proud of the process because I would like to be able to offer you a final rule. I do not feel comfortable sitting here having to hide behind either the Administrative Procedure Act or a Presidential moratorium. There is nothing I can do about either of those provisions, and therefore we are stuck with that.

That is a fact of life for purposes of this hearing, but the fact is, the essential point remains the case: this is the kind of industry that is better addressed in the regulatory process under any circumstances, even a prolonged regulatory process, than through the legislative process.

Senator MCCAIN. Well, Mr. Shane, would you repeat the first part of your statement that a rulemaking made in 1992 might have some problems in 1993?

Mr. SHANE. No, I said legislation.

Senator MCCAIN. But a rule would not?

Mr. SHANE. No, a rule might.

Senator MCCAIN. What you are saying, then, there is going to be no rulemaking; is that correct?

Mr. SHANE. No. I am saying that the rulemaking process is a far more inherently flexible process than the legislative process. You have delegated to the executive branch certain rulemaking authority with respect to the airline industry and I would say that was a successful delegation. It has worked for the vast majority of everything we have done. Let us not run away from our success.

Senator MCCAIN. Well, it is unacceptable.

Mr. Shane, on page 11 of your statement you are talking about the hubbing issue:

> This is considered very good news because of a concern that as hubbing practices matured, hubbing carriers might be able to tighten their grip on a respective connecting hub and extract even greater premiums from additional passengers. That is not happening.

According to the Washington Post and the Associated Press, Mr. Patrick Murphy, who is the Deputy Assistant Transportation Secretary for Policy and International Affairs says, "air travelers are charged an average of 20 percent more for flights out of hub airports that are dominated by one or two airlines than for comparable flights from airports where competition is stronger, Government investigators reported yesterday."

How does that match up with your statement, Mr. Shane?

Mr. SHANE. My statement repeats my deputy's earlier testimony. He said that there is a premium, in fact, at these hubs. These are clearly hubs that do not enjoy the level of competition that we think they should, and there is a fare premium charged there. I think it is closer to 19 percent than 20, but we will not quibble.

My point was that we knew that when we did our study in 1990. That is not news. We have known about a fare premium at hubs. It has been a fact of life for some time, and despite all of the concern about increasing consolidation and diminishing competition, the fact is that the fare premium remains exactly the same as it was. It is not getting worse.

But the most important feature of the fare premium is that it is a fare premium that affects only 5 percent of passengers in this market. The fare premium at concentrated hubs is not the big story about the deregulated market. The big story about the deregulated market is there is far more competition today than there has ever been before.

Fares are lower, service is provided in greater abundance—it is a success story, and I know that we have a difference about that, Senator. We have a difference every time I show up here, but the fact is, I keep returning to the numbers and the numbers continue to look good to me and to look good to objective analysts at the Brookings Institution, at GAO, and other places. And yet we keep having this argument. So, I am sorry to raise my voice, but the frustration is not only on that side of the table.

Senator MCCAIN. The GAO does not say that, Mr. Shane. In fact, the GAO says just the opposite. You and I both know that the latest study a couple of months ago indicated that CRS's still have bias in favor of the large carriers. I would like to place in the record correspondence at this point.

[The information referred to follows:]

LETTER FROM KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES, GENERAL ACCOUNTING OFFICE

JUNE 9, 1992.

The Honorable JOSEPH I. LIEBERMAN,
The Honorable JOHN MCCAIN,
U.S. Senate,
Washington, DC 20510

In your letter dated June 4, 1992, you asked us to clarify the recommendations concerning computer reservation systems (CRS) contained in our March 1992 report, Computer Reservation Systems: Action Needed To Better Monitor the CRS Industry and Eliminate CRS Biases (GAO/RCED–92–130, Mar. 20, 1992). Your letter noted that some parties have interpreted our report to mean that the GAO is recommending further data collection and study before any CRS reforms are implemented. This interpretation is incorrect.

Our March 1992 report contained two recommendations. First, we recommended that the Congress direct the Secretary of Transportation to revise the Department's existing CRS rules to require that each CRS vendor eliminate those functional differences between host and participating airlines that can be eliminated without dehosting. Second, we recommended that the Secretary of Transportation gather data on the CRS industry, the reliability of communication links, and the costs and benefits of dehosting CRSs.

On the basis of our discussions with CRS owners and participating airlines, as well as our observations of CRS operations, we believe that some remaining functional differences can be eliminated at a reasonable cost, independent of dehosting. Such differences include those resulting from programming or procedures that make it more efficient to book flights or obtain information on host airlines. CRS vendors agree that these differences, to the extent they exist, should be eliminated. The vendors have stated that they are acting to eliminate some of these differences to remove any possible adverse competitive effects as well as the perception that participating airlines operate under a competitive disadvantage. We recommended that the Congress act to ensure that the vendors follow through on their plans to eliminate such differences.

We did not recommend dehosting at this time because the Department of Transportation has not collected recent data that would allow us to assess the costs and benefits of a dehosting requirement. We were unable to confirm whether dehosting would provide significant benefits over an equal functionality requirement, the subject of our first recommendation. Specifically, there is no consensus on the cost of dehosting to CRS vendors, airlines, and passengers. Also, data on the reliability of communication links and travel agent behavior are needed. Finally, the impact of recent changes in the CRS industry, such as technological advances and ownership

diversification, should be assessed before we make a recommendation concerning dehosting.

In our March 1992 report, we were asked to focus specifically on the issue of architectural bias. In previous reports and testimonies, we have addressed other CRS issues, such as the travel agent/vendor relationship and the level of booking fees charged to participating airlines. In our previous work, we have discussed options to address these issues, such as placing restrictions on booking fees, reducing the maximum length of subscriber contracts, and regulating certain contract provisions.

I hope this clarifies our recommendations. If you or your staff have additional questions, please contact me.

KENNETH M. MEAD,
Director, Transportation Issues.

Mr. SHANE. I was referring to the GAO study about whether there is more competition in the market.

Senator MCCAIN. The GAO has sounded the same alarm before this committee about consolidation of the airline industry.

My point is, Mr. Shane, if air travelers are charged an average of 20 percent more for flights out of hub airports that are dominated by one or two airlines than for comparable flights from airports where competition is stronger, then we are seeing the inexorable evolution of events that will lead to more and more hub airports that are dominated by one or two airlines if we are seeing a consolidation of the industry, which is clear.

In 1984, 10 air carriers had 80 percent of the airline business. Now, five have 80 percent of the airline business. Clearly we are seeing the movement toward more and more hubs where only one or two airlines dominate if you are getting fewer and fewer airlines.

Mr. SHANE. Well, Senator, there is a leap of faith there. What I have said is that the dominated hubs have not increased in terms of the fare premium charged. I did not say that there are more and more dominated hubs. Quite the contrary. There are more city-pair markets today. There are more competitive markets today. There is not an increase in the number of dominated hubs, so that is not what the studies show.

Senator MCCAIN. Do you accept the airline industry analysts' view that several airlines will go out of business in the next 6 months to a year?

Mr. SHANE. No.

Senator MCCAIN. You do not accept that?

Mr. SHANE. No. I have no basis upon which to accept it.

Senator MCCAIN. You do not believe any airlines are going to go out of business?

Mr. SHANE. I do not have any basis to believe——

Senator MCCAIN. I am just asking for your opinion.

Mr. SHANE. I do not believe so. I do not think that there will be a necessary demise in any airline company between now and 6 months from now; no, sir.

Senator MCCAIN. I have used up my time. Thank you, Mr. Chairman.

Senator FORD. Let us see if we can hold it to 10 minutes, and if you have not finished questioning after we get a round we will be glad to come back. Senator Bryan.

Senator BRYAN. Mr. Chairman, thank you very much.

Mr. Shane, you give us a very sanguine assessment of the condition of the airline industry which in my own view does not square

with reality, but let us just assume for purposes of this discussion that your assessment is incorrect, that indeed, as Senator Danforth has indicated with TWA, and Senator Stevens has indicated the situation in Alaska, as Senator McCain and I know the very difficult situation that America West finds itself in our own part of the country, let us assume for the sake of argument that there is a collapse and that these carriers are unable to extricate themselves from bankruptcy or receivership or other types of financial problems, what is the assessment?

In Nevada, for example, Las Vegas, America West has about 40 percent of the flight originations. Let us suppose they do not make it, or in St. Louis TWA does not make it, or in Alaska the carriers that Senator Stevens talked about. What is the impact for the American public?

Mr. SHANE. Well, when I say I have no basis for believing that there will be a demise of one or more carriers between now and 6 months, I am not offering an opinion—understand, I am not running away from the possibility that you could lose one or two airlines under some circumstances.

But I do not believe that the loss of one or two airlines at this point would have any dramatic impact on the availability of travel to the American public, the reason being that the airplanes do not go away. There will be carriers to jump in. We have new entrant carriers, some of which are looking at new markets, and I believe that you will find that there will be replacement service in very short order. That has been the experience in the past.

Senator BRYAN. So, you are saying if America West should not make it that from the standpoint of Nevada, which is heavily dependent on tourism as the economic expansion that has propelled the fastest growth in America in the last decade, that really there ought not to be any concern on the part of citizens in my own State in terms of the ability of people to travel, mostly by air now in terms of tourist markets coming into the State, that there is not any reason for us to be concerned?

Mr. SHANE. Of course I am not saying that, Senator. I am saying there will always be that service. The service will be there. It may not be provided by the carrier that they want to stay there. My hope is that it would be provided by more than one carrier, and the question really is, Are there any impediments to finding that replacement service?

We lost Eastern. Eastern was a much bigger airline than America West, and when it disappeared it did not cause an upheaval in the air travel market that Eastern Airlines had served. There were replacement carriers in place in very short order, not only in the United States, but even on Eastern's international routes.

Senator BRYAN. Mr. Shane, with all due respect, let me suggest that answer is a bit disingenuous in the sense that if you take an overall global market, or even a national market, it may mask considerably the impact that it has on a particular local market. That is, overall a national impact may be minimal, but it may be a dramatic and profound impact on a local market, whether it is a Las Vegas, or a St. Louis, or Alaska.

Let me cite, for example, one time after the surge of airline expansion after deregulation the Las Vegas to Reno market had four

or five different carriers. The price was exceedingly attractive, the number of travel options you had each day was extraordinarily generous. Then we went down to a single carrier.

Now, that may not have had much of an impact on the national statistics, but I can tell you the cost to travel between Reno and Las Vegas when we had just a single carrier literally went through the ionosphere. Every business person, every traveler that came to Nevada for purposes of travel or whatever the purpose might be felt that impact immediately.

Now we have got some competition in that market, and the prices have stabilized, admittedly, but the reality and the experience—not the theoretical projections, not the overall calculations and massaging the numbers—indicate that if we lose America West we are going to have a dramatic impact in a market which is of vital concern to me.

Is that not the experience, as you see it, based upon a carrier that leaves a market and you do not have a competitive interval where someone comes in and takes over that market?

Mr. SHANE. If you did not have a replacement carrier, if you did not have a market that was attractive to a replacement carrier, I grant you as a matter of logic, yes, indeed, prices could increase. But what you are talking about are markets that are inherently attractive, and I believe that you will have replacement service in the unlikely and unfortunate event of America West's departure.

Senator BRYAN. Another question, if I may. The predatory pricing—I mean, we are seeing all of these extraordinary fares and my understanding is one of the major carriers initiated this most recent round of price war. Would you agree with that?

Mr. SHANE. Yes. Well, let me just say that was true of the initial kickoff. The most recent initiative in late April was a Northwest fare, a fly free with your children fare, and yes, then an American response and the rest is history.

Senator BRYAN. Now, from your perspective long-term, and admittedly there is some short-term attractive fares that has caused an influx of activity and there will be some short-term immediate benefits—I mean, the number of hotel bookings in my own State have gone up dramatically, and so this summer looks good, but obviously you are not in the market just for the summer, you are long-term. What is the impact as you see over the long range of this most recent price war?

Mr. SHANE. I wish I had a crystal ball. I think that the long-term impact of the fare simplification initiative will be a salutary impact. I think American in proposing it was serious about that. They were widely complimented throughout the industry—I mean, throughout the travel industry—for having done it. American will maintain, I am sure, that their response to what Northwest did was simply an effort to get back to that essential core objective.

I do not propose here to try to evaluate anybody's motivation in all of this.

Senator BRYAN. I am not asking for the motivation, I am asking for what you think the impact is.

Mr. SHANE. I think the impact for this summer is going to be catastrophic in terms of revenues. They certainly have front-loaded all the revenues for the summer. Again, I said I am not sure how

many seats were kept out of some of these very, very low promotional fares. There may very well be seats that are still available for purchase at higher fares and people will want to travel and will be making plans as the summer moves on, and so we certainly have not seen the whole summer story written, but surely this fracas within the airline industry is going to cost in terms of yield, I know that.

Senator BRYAN. But should we not be concerned as a matter of public policy as to what the impact is going to be long term on the number of carries that survive and the competition that is out there in the airline market?

Mr. SHANE. There is no question. Of course you must be concerned, and I would be extremely concerned if it became apparent that the kinds of fare competition that we are seeing in the market either represented a genuinely predatory practice, a destructive practice, or if indeed there were clear evidence that you were accelerating the demise of a significant number of airlines.

That evidence does not exist today. There is a lot of wringing of hands, and I have no doubt that some of the folks wringing hands are very serious about it and they may know more than those of us in Government know at the moment, in terms of statistics available to them, but I think it is too early to sound any alarms on that front and I certainly do not propose that we get into the business of trying to second-guess any airline manager's decision as to how to respond to a competitive challenge.

Senator BRYAN. I guess my response, Mr. Shane, is I am afraid we might be too late.

Let me ask you, assuming that these airline financial difficulties are exacerbated, as I think they surely are going to be, and that indeed they may prove to be terminal for some of these carriers, and I apprehend that may be the case as well if we got down to only three carriers in America that provided any type of national service, would that be of any concern to you in terms of policy?

Mr. SHANE. I think it should be a concern to us. We would want to take a look at the way those carriers were operating in competition with each other.

Senator BRYAN. I am talking about just the number. Would that be of concern, if indeed this thing, this economic Darwinism that Senator McCain talked about, if it got down to three carriers, would that be of concern?

Mr. SHANE. Speaking personally, I would be concerned, I must say that, and forgive me for jumping in. I think that is an area that is the null set. I cannot envision a circumstance in which we would ever, ever reach an airline industry populated by three carriers.

Senator BRYAN. I am talking about three national carriers now.

Mr. SHANE. Three majors? Again, I think this market is simply too big and too robust and too inviting to allow that to happen. I do not see that as a major policy objective of the Department, what to do about the three-carrier scenario. I just do not think it is there.

Senator BRYAN. Mr. Shane, you may be right and I may be wrong on this, but it seems to me that there ought to be some responsibility on the part of the Department to at least analyze what

the impact will be and to prevent that from occurring, and it seems to me your assessment is it is not going to happen.

You do not think it is going to happen, but I do not really see any contingent planning at all, if, indeed, there is some benchmark that comes down the road that would suggest to you that indeed your earlier, more optimistic assessments are not proving to be the case, for you in effect to take some action. It seems to me we are just letting this thing just kind of continue to go downhill.

Mr. SHANE. I am sorry, I really have not addressed what we are doing. We are certainly monitoring the industry as closely as we can. We are in close touch with the industry. Every time there is a new initiative we get in touch with the carriers. I would like to think we have our finger on their pulse. I do not mean to suggest we are just sitting back and letting it all happen. Secretary Card has insisted we provide him with daily information on this, and we are doing that.

Senator BRYAN. Thank you very much, Mr. Chairman.

Senator FORD. Senator Kasten.

Senator KASTEN. Mr. Chairman, I would like to, if I could, yield my time to Senator Stevens and then reclaim my time in his regular order.

Senator FORD. Well, if you do that, then you will come next round.

Senator Stevens.

Senator STEVENS. Mr. Chairman, I thank Senator Kasten and Mr. Shane. Knowing the courtesy that has just taken place, I have four questions and I would prefer to just use 5 minutes.

First, let me state this. I was told yesterday that there have been many unfair trade practice complaints under section 411 and petitions to the Department to enforce current CRS rules, and the Department has done nothing on any of them. Is that right?

Mr. SHANE. I can check the record on whether we have had many complaints. I believe if they have come in we have deferred action on those complaints until such time as we have a new rule.

Senator STEVENS. That applies to the unfair trade practice complaints also.

Mr. SHANE. Yes, but again I apologize. I am just not sure.

Senator STEVENS. Well, I would appreciate if you would put something in the record on it, because I am trying to expand this bill, and I think that means that 411 and the current rules need, obviously, attention.

[The information referred to follows:]

A SUMMARY OF DOT ENFORCEMENT ORDERS IN THE CRS AREA

1. **Order 87-11-46**—*Trans World Airlines*—This consent order assessed a $12,000 civil penalty against Trans World Airlines, in part for inaccurately displaying fare information in PARS. The case was based on an informal travel agent complaint.—**Proceeding duration: 3 months.**

2. **Order 87-12-34**—*American Airlines* v. *Eastern Air Lines,* Dkt. 44891—This order dismissed an American Airlines complaint against Eastern Air Lines which alleged that Eastern used an inadequate number of connecting points in its CRS displays. There was no evidence of a violation.—**Proceeding duration: 7 months—Extra time needed to retrieve and analyze evidence.**

3. **Order 88-2-4**—*Trans World Airlines* v. *United Air Lines* and *British Airways,* Dkt. 44842—Trans World filed a formal complaint that alleged that United, through its GAS (Apollo), and British Airways, which supplied certain international fare data to Apollo, failed to provide a current fare listing with respect to TWA. The final

order approved a consent agreement under which United agreed to an assessed civil penalty of $45,000 and agreed to take steps, accomplished at the time of the order, to obtain and include in its CRS more accurate and complete international fare information.—**Proceeding duration: 9 months—Time needed to effectuate reprogramming of computers.**

4. Order 89-1-31—*Aer Lingus* v. *Delta Air Lines, American Airlines, Texas Air Corp., Trans World Airlines, & United Airlines;* Dkt. 45519—This order dismissed Aer Lingus' complaint against the five U.S. carrier respondents (all CRS vendors at the time). Aer Lingus had complained that Delta, and other vendors, listed single flight number connecting service as if it were single plane service, thereby disadvantaging Aer Lingus which did not provide single plane service in certain Ireland-U.S. markets. The case was dismissed since (1) those vendors that were not already in compliance took prompt corrective action, (2) the violations were technical and inadvertent in nature, and (3) nothing would be gained by additional enforcement action.—**Proceeding duration: 10 months—Time needed to effectuate reprogramming of computers.**

5. Order 89-9-35—*Delta Air Lines* v. *American Airlines,* Dkt. 44094—The complaint alleged that American unfairly biased its SABRE displays by ordering flights according to unrealistic elapsed flight times. Delta claimed that SABRE gave preference to American flights by using elapsed times for American flights which did not reflect operational experience. The order dismissed the complaint when American agreed to undertake remedial action to correct its CRS elapsed times and in view of certain settlement agreements concerning unrealistic scheduling which were reached with carriers, including American and Delta, in August 1987.—**Proceeding duration: 39 months—(1) Corrective action taken in less than 12 months; (2) complaint dismissed after monitoring compliance by carriers with settlement agreements which were in effect for two years.**

6. Order 90-1-29—*Northwest Airlines* v. *American Airlines,* Dkt. 45641—Northwest alleged that the minimum use clause in American's standard SABRE contract with travel agency subscribers represented an unfair competitive practice in violation of section 411 and served as an indirect prohibition on the use of another vendor's system, such as Northwest's PARS, in violation of the Department's rule on carrier-owned CRSs. The order dismissed the complaint, stating that the complaint failed to present substantial evidence that probable violations of the CRS rule had occurred. The order also noted that the minimum use clause issue was under consideration in the pending Department GAS rulemaking.—**Proceeding duration: 20 months—Dismissal delayed for issuance of ANPRM.**

7. Order 90-1-30—*Hanover Travel* v. *Northwest Airlines,* PARS Marketing Partnership, Dkt. 45593—This complaint stemmed from the same factual circumstances as the Northwest complaint above. Hanover, a travel agency, claimed that Northwest's PARS system imposed a minimum use clause that it, as a small agency, could not meet since it already had installed several SABRE terminals subject to minimum use provisions. The order dismissed the complaint on the grounds cited in Order 90-1-29.—**Proceeding duration: 21 months—see 6.**

8. Order 90-1-31—*AA Cruise and Travel, American International Travel, Butler's Travel Station* v. *Delta Air Lines, Morris*/Ask Mr. Foster, Murdock Travel, Bonneville-Beehive Travel Group; Dkt. 45796—Several travel agencies filed a complaint against Delta, alleging that Delta marketed a disproportionate share of its discount seats through the larger agencies listed as co-respondents. These agencies were all subscribers to DATAS II, at that time the Delta CRS. The complainants alleged that Delta offered special discounts for the acquisition of DATAS II equipment and large blocks of discounted fares to the large agencies, in violation of the GAS rules and section 411. The order dismissed on the grounds that no vendor is prohibited from offering discounts and incentives to potential subscribers, so long as subscribers are not required to use a single vendor's product exclusively. The on-going rulemaking is dealing with this issue.—**Proceeding duration: 21 months—see 6.**

9. Order 90-1-32—*System One Direct Access, Continental Airlines, Eastern Air Lines* v. *United Air Lines, Covia Partnership, and Covia Corp.;* Dkt 45758—*System One Direct Access, Continental Airlines, Eastern Air Lines* v. *American Airlines;* Dkt. 45759—These two complaints, filed contemporaneously, claimed that the two largest vendors' subscriber contracts impermissibly restricted agencies from using the other vendors' systems and that SABRE and Covia architecturally biased their systems in a way favorable to their carrier owners. The order dismissed the complaints, stating that they failed to adduce any new convincing evidence that either United or American were engaged in conduct prohibited by section 411 or the CRS rule. The order also noted that the on-going rulemaking would address many of the issues raised by the complainant.—**Proceeding duration: 21 months—see 6.**

10. Order 90-9-26—*Universal Travel of Virginia Beach, Inc.* v. *Delta Air Lines;* Dkt. 46920—This complaint alleged practices on the part of Delta similar to those described in the Hanover and Northwest claims supra. Delta's contract, according to the complainant, required that Universal maintain at least a minimum ratio of Delta to Apollo CRS terminals at its agency locations. The final order dismissed the complaint on bounds that it failed to present a case that probable violations of the CRS rule or section 411 had occurred, stating that there was no strict contract prohibition on Universal's ability to acquire Apollo terminals in the future but only a condition that if it did so it would have to continue to meet the ratio requirement.— **Proceeding duration: 5 months.**

Senator STEVENS. Second, do you see any evidence of predatory pricing in the airline industry today in the United States?

Mr. SHANE. Predatory pricing is a very, very difficult charge to make.

Senator STEVENS. That is not what I asked you. Do you see any evidence of it?

Mr. SHANE. I am the Assistant Secretary for this area of law and I have to be pretty responsible in my answer to that question. To this point, I do not; no, sir.

Senator STEVENS. Third, with regard to the transfer of assets in bankruptcy, do you see a changing effect on the industry itself and the economics of the industry because of the control of the bankruptcy judges?

Mr. SHANE. No.

Senator STEVENS. You see no impact at all so far from their actions?

Mr. SHANE. My point is that the bankruptcy judges certainly have control of the case to the extent they are looking out for the estate that is before the bankruptcy court. But a lot of the transactions that take place require, in addition to a bankruptcy court's approval, the approval of the Secretary of Transportation as well, and there is not anything that the bankruptcy court does that binds the Secretary of Transportation. So, if any transaction in the bankruptcy court affected the industry in ways that were not consistent with the public interest, the Secretary of Transportation would invalidate that transaction.

Senator STEVENS. Could.

Mr. SHANE. Could. He has not done so yet.

Senator STEVENS. Fourth, I notice you bear the title of Assistant Secretary for Policy and International Affairs. How much time do you spend on each?

Mr. SHANE. About half and half.

Senator STEVENS. And it should take two men for each; should it not?

Mr. SHANE. I would like to have 10 for each, Senator.

Senator STEVENS. Do you see an inherent inconsistency in your job in determining domestic policy and negotiating overseas for the people that you are in effect regulating through your policy domestically?

Mr. SHANE. No, I do not see any inconsistency. On the contrary, I think the evolution of this industry into a global industry really requires that there be an integration of those two functions. You cannot possibly understand what is going on in this industry unless you understand what is going on abroad. That is a fact of life.

Senator STEVENS. Well, respectfully I would say that when you have to get from Holochachuck to Bethel in order to get from

Holochachuck to Anchorage and then you have to get from Holochachuck to Bethel to Anchorage to Seattle in order to get to see me in Washington, DC, I do not think you understand that. Do you fly very much?

Mr. SHANE. Much too much, Senator.

Senator STEVENS. I am serious. Do you fly much in the system?

Mr. SHANE. I certainly do; yes.

Senator STEVENS. Domestically?

Mr. SHANE. Yes, sir.

Senator STEVENS. You have not noticed a change in the last 2 or 3 years in the system?

Mr. SHANE. In the last 2 or 3 years I have not noticed a change; no.

Senator STEVENS. I think you have been negotiating abroad too much.

Mr. SHANE. I have not negotiated abroad in the last 3 years, Senator.

Senator FORD. Senator Danforth.

Senator DANFORTH. Mr. Shane, if you were flying on TWA and one of the employees came up to you and asked about the future of that airline, what would your answer be?

Mr. SHANE. Cautiously optimistic.

Senator DANFORTH. Is that the position of the Department of Transportation?

Mr. SHANE. The position of the Department of Transportation's would be the Secretary's to spell out. I did not come here prepared to offer a position on the financial prospects for any individual carrier.

Senator DANFORTH. But there are some who would take a very bleak view of the future of TWA, but you would not share that view?

Mr. SHANE. I just do not feel the least bit comfortable in offering opinions about the financial viability of private companies, which opinions would be headlines in the financial press tomorrow.

Senator DANFORTH. You know, we in Government set something in motion with deregulation, and then we seem to be, for some good reasons such as the one you just stated, almost paralyzed, I think, in coming to grips with real concerns of people.

We say we do not want to legislate because that locks us in. We do not want to regulate because for some reason that gets bogged down. We do not want to voice opinions about the viability of airlines, so all we are left with is sort of general rosy statements about the future of airlines.

Mr. SHANE. My testimony has been characterized several times as sanguine. I guess perhaps that is necessarily the result of testimony which is designed to oppose legislation which at least the sponsors would like to see passed in order to solve a lot of problems.

I am certainly not sanguine about the immediate future of the airline industry. Its earnings picture is awful. It has gone through the worst long, dark night of the soul in its entire history. This is a matter of public record. I am not denying any of that.

I started my testimony by saying the airline industry faces challenges unlike any it has faced up to now. That is all the case.

All I am suggesting is that the airline industry has shown tremendous resilience not only as an industry but in individual carrier cases as well, and that we have derived enormous, enormous economic benefits for the entire economy of this country for the last 12 years. I just—I would just hope that we not run away from the success story that deregulation is by coming in and intervening in this industry in ways that may not be helpful to its long-term prospects.

Senator DANFORTH. The fact of deregulation is that right now seven airlines have 90 percent of the market; is that right?

Mr. SHANE. I would be happy to check that for the record. That may be right, but my earlier point was that it is not a single market for purposes of those kinds of statistics. It is not a helpful statistic to talk about who has the most traffic in the United States. There are 20,000 markets in the United States. The question is how much competition is in each of those 20,000 markets, and that is what I keep talking about. I keep talking about the fact that there is more and more competition in those city-pair markets in which passengers actually make choices every day.

[The information referred to follows:]

For the year ended March 31, 1992, the top seven airlines, measured in terms of revenue passenger miles (RPMs), account for 87.4 percent of domestic RPMs and 87.9 percent of system RPMs. The top eight airlines account for 91.2 percent of domestic RPMs and 90.9 percent of system RPMs.

Senator DANFORTH. So, people in St. Louis who fly out of Lambert, where 80 to 85 percent of the traffic is TWA now, the basic answer to them is look, there are a lot of airlines around.

Mr. SHANE. No. No. We talked earlier——

Senator DANFORTH. I mean, maybe they could fly Air Alaska or something out of St. Louis.

Mr. SHANE. There are eight concentrated hubs and we had a colloquy about those hubs earlier. Those are the pockets of problems that we have been concerned about from the beginning. There is not sufficient new entry in those areas and not sufficient competition. I do not deny that.

That is a problem that we face and that we want to address, and that is certainly a problem which the Congress wants to address, and I fully support Congress' concern about that. I am just suggesting that you give the administration a little more time to try to do it.

Senator DANFORTH. So, that is what I should tell the stewardess who comes up to me the next time I fly to St. Louis. "Just give the administration a little more time and all is well. Lighten up."

Would the administration, would the President, veto Senator McCain's bill?

Mr. SHANE. I know the administration is strongly opposed. We have not had a conference on whether or not the opposition would rise to a veto.

Senator DANFORTH. Would you recommend a veto?

Mr. SHANE. Would I personally? I would recommend a veto.

Senator MCCAIN. Would the gentleman just yield for one comment? You know that the provisions of the bill are the exact provisions of the proposed rulemaking, and he would still oppose and recommend a veto.

Mr. SHANE. Proposed rulemaking. I do not know what will be in the final rulemaking. I would like to be able to decide that.

Senator MCCAIN. Excuse me, the nearly 2-year-old proposed rulemaking.

Senator DANFORTH. Let me follow up on Senator Stevens' question about your particular dual function in the Department of Transportation, not so much from the standpoint of your specific role, but the basic philosophy of the Department.

I believed at the time that TWA was selling off international routes that the Department of Transportation was more interested in international competition than in domestic competition, and the basic view of the Department was look, we would rather have three strong, surviving international airlines which could compete in international competition with the very strong airlines that exist throughout the world than to have more airlines which are competitive domestically. So that, as far as the weighting within the Department was concerned, the weighting was in favor of international competition: strongly competitive international airlines, as opposed to domestic competition. Is that your view?

Mr. SHANE. I do not recall the deliberations taking on that color. The issue before the Secretary of Transportation was simply, is a particular route transfer in the public interest, and his decision at that time was it is in the public interest. There is no justification for opposing a transfer.

I will say that the net result of that transfer and a host of other transfers that were considered and approved by the Department of Transportation—some like that one with significant modifications by the Secretary, others without any modification at all—all of those transfers have created clearly the strongest and most competitive and most robust airline industry in the world, to the point where some of our competitors on the other side of the Atlantic in particular are expressing enormous concern about whether or not they can deal with a transatlantic market that includes these lean, mean machines that come out of the U.S. deregulated market.

Senator DANFORTH. Most people have assumed that American and United and Delta are going to be the three surviving airlines. If the thrust of the administration is that these should be three strong airlines that are internationally competitive, then to the extent that power is concentrated in those airlines, that would be viewed by the Department as a good thing.

Mr. SHANE. No, sir. In my exchange with Senator Bryan, I emphatically rejected the three-airline scenario. Certainly that plays no part in any Department policy, and I frankly do not even believe, just as a matter of an economic prediction, that it would ever come about.

Senator DANFORTH. Let us suppose that an airline is engaged in predatory pricing. What does the competition do?

Mr. SHANE. If it were predatory pricing in the classical sense, then the competition would, as it apparently has done, go to court as one possible alternative, and another alternative would be to come to the Department of Transportation and make a case that unfair competitive practices are in fact taking place within the industry and the Department would be required to issue orders to ban those practices.

Senator DANFORTH. That would be a pretty hard case to make within the Department; would it not?

Mr. SHANE. It would, yes, Senator.

Senator DANFORTH. Would it be a wheel-spinning operation?

Mr. SHANE. I should not prejudge any particular case. It would depend upon the facts.

Senator DANFORTH. This would be something that would be on your desk; would it not?

Mr. SHANE. Ultimately it would be on the Secretary of Transportation's desk, but I would certainly advise him along with the General Counsel of the Department, and yes, DOT would be compelled to make a decision, surely.

Senator DANFORTH. Would it be, just as a practical matter, a waste of time for an aggrieved airline to come before you with this kind of case? Would it be such a hard case to make before you that the court and only the court would be the way to go?

Mr. SHANE. It is just difficult to answer the question in the abstract. It is a very difficult case to make. There have not been many successful predatory price prosecutions or civil damage actions. I think that should weigh heavily in any proposed complaining party's consideration of strategy.

Senator DANFORTH. But you do believe that price wars do have a damaging effect on airlines.

Mr. SHANE. Certainly a price war that goes on like the one that we have seen is certainly going to damage the revenue picture for airlines, and we have seen a lot of damage take place for the summer, no question.

Senator DANFORTH. Thank you, Mr. Chairman.

Senator FORD. Senator Kasten.

Senator KASTEN. Mr. Chairman, thank you.

On page 6 of your testimony you stated: "I am not suggesting as a consequence that any of the big three airlines are in a position to dominate domestic markets." How do you define, or how would you define dominating a domestic market?

There are some that would say that if 75 or 80 percent of the flights in and out of St. Louis are on TWA that TWA is dominating that market. Does that 75 percent have to go to 80, 85, 90, 95, 99? When would you say that one airline is dominating that market?

Mr. SHANE. I would say TWA dominates that market today.

Senator KASTEN. How about in the case of Minneapolis, where you have got x percent of Northwest? How high would you have to go in terms of dominating that market before you would say Northwest dominates the market in Minneapolis?

Mr. SHANE. Northwest dominates Minneapolis.

Senator KASTEN. How about Detroit? If you are talking about dominating a market, where would you have to go in terms of does Northwest dominate that market?

Mr. SHANE. When we see fare premiums along the lines that we see in places like Detroit, Minneapolis, and St. Louis, and we see there is a single carrier that is dominating the market, those are the problems.

Senator KASTEN. Then I do not understand what you mean on page 6, where you say people are not dominating domestic markets. This is the middle of the bottom paragraph. It seems to me we are

saying at least in those few that we just quickly picked out there in fact is a domination of the domestic market by a particular airline.

Mr. SHANE. The premise I am dealing with is the notion that what you see in some of the concentrated hubs today, which we identified as I say a couple of years ago and which are a problem, is merely a harbinger of what you are going to see across the country. That is what I was talking about—the idea of this disease spreading to markets throughout the United States. I do not see that happening. I do not see this concentrated hub phenomenon expanding.

Senator KASTEN. So, you really should change your statement and say that there will not be further domination of domestic markets but we accept the domination that exists.

Mr. SHANE. No, we do not accept the domination that exists, and I would not change my statement to that effect. That domination is precisely what our initiatives are about. The idea is to get new entry and real competition into some of those dominated hubs.

Senator KASTEN. Talking about now new entry, in response to Senator Bryan you said if we lose two airlines we would have new entrant carriers jump in. Could you name, over the past 2 or 3 years for the record, the names of the new entrant carriers that in fact have jumped in as we have seen Eastern and others go back? It seems to me there are a relatively limited number, and maybe none at all that I can name in the last 2 years, that have jumped in.

I think what has happened in fact is we have increased the domination that you were talking about being concerned about. Have new entrants, in your own words, jumped in, or in fact have we just increased the concentration of the existing airlines as people like Eastern fall by the wayside?

Mr. SHANE. It is an evolving picture. When Eastern went away we had in effect a bidding war before the bankruptcy court for Eastern's operations out of Washington National. Northwest created a major new hub at Washington National in competition with the other carriers that were already hubbing here.

Senator KASTEN. Would Northwest be categorized as a new entrant carrier that would jump into the Washington market?

Mr. SHANE. That is what I meant, yes. A carrier that was not already in the Washington market, to the same extent that it then could become a hubbing carrier in Washington.

Senator KASTEN. In other words, you are calling new entrant carriers not necessarily new carriers, just new entrants into a particular market.

My point here is that in the process of the changes that have taken place it has been a further concentration, not new competitors, not new entrants. It has been airlines that are presently expanding and in fact expanding their dominant power into new markets where they had not previously been major players.

Mr. SHANE. That is right.

Senator KASTEN. That is what is going on. We do not have new entrants and more competition in the system.

Mr. SHANE. No, I did not necessarily mean there would be an increase in the population of the U.S. airline industry.

Senator KASTEN. You spoke about rulemaking in response to Senator McCain, and you said that rulemaking has worked. In your words, we should not run away from our success. I do not understand where rulemaking's success has worked over the last couple of years.

You obviously are frustrated and you share our frustration, and there is frustration on both sides of these tables as you have correctly pointed out. Maybe rulemaking has worked in the Department of Labor somewhere, or maybe rulemaking has worked at some other part of the Department of Transportation, but I do not think there is a person in this room that thinks that rulemaking has worked, and we should not run away from our success in rulemaking in this area.

We have not been successful at all either with regard to computer reservation systems or with regard to new entrants and slot use. Are you suggesting that somewhere there is a part of this that we are missing, that we have had a great success?

Mr. SHANE. Yes, I think we have had a great success, and I guess everybody is missing it. The industry is a success in terms of what it was before 1978.

Senator KASTEN. I am talking about rulemaking.

Mr. SHANE. You asked me what I said in my statement. I am trying to explain that, Senator. What I said is the rulemaking process has been a success. It has been a success as much because we have been lighthanded in the application of the rulemaking authority that the Department has as anything else.

The chairman asked, is there a difference in the CRS industry and has that difference been attributable at all to the rulemaking process, and I said yes to both questions.

It is a different industry today. It does not have the display bias that it had before the CAB promulgated the first rule. That has been essential to competition in the industry. It was an essential part of the success of deregulation, and so you see examples like that throughout the industry, and I believe the rulemaking as applied by the Department of Transportation, not without important differences of opinion with important committees of the House and Senate, has nevertheless in the main been a success story.

Senator KASTEN. On page 7 you used Midwest Express as an example of a very small airline that has rapidly expanded, et cetera. I think it is just important get on the record that you and I both agree that the expansion of Midwest Express has not been to the key hub, high-volume airports.

The expansion of Midwest Express has been because of their entrepreneurial work at finding little places to fly to and it is not the way that they would like to expand. They are being prohibited from expanding, because of the systems presently in place, into the markets they want to go in. Their expansion has been primarily into the nonhub airports. You would agree with that; would you not?

Mr. SHANE. I would, yes.

Senator KASTEN. In order to have better competition for a number of airlines, you would agree that we ought to be able to have flexibility in terms of expanding into some of these newer markets as well as flexibility for new entrants or for limited incumbents into hub airports and there ought to be opportunities for America

West and other people to come into both kinds of airports and that would be the goal of your policy, is that correct?

Mr. SHANE. Yes.

Senator KASTEN. In roughly, I think it was about a year ago, when you all came out with the proposed rule 24 hours before the hearing or 12 hours before the hearing, whatever it was, one of the points in that was how we define the use of a slot, and we have discussed this at least twice, I think, me sitting here, you sitting there.

With regard to the concept of babysitting slots and whether or not a slot should be defined as being utilized at 60 or 65 percent, in the rule that you all proposed shortly before the previous hearing, a proposal was to go to 90 percent in order to define the use of a slot.

Why can we not move at least on that one small part of all this and is it a fact that just some of the larger airlines that are controlling these slots at places like Washington National and La Guardia are just blocking you, or is there an economic reason, or what is going on here?

It seems to me that we have something that is of value. There is a debate as to whether or not they ever bought it, but right now it is for sale, and I am not going to go into that debate, but why can we not just move on that one section?

Just in terms of public policy we ought to have people utilizing to a greater extent something that has become an asset, and if we are able to just make that one change maybe to 80 or 85 percent and knock out some of the people that are babysitting those slots and give opportunities to some of the limited incumbents or new entrants, just that one change could solve a lot of the problems that you have got every time you come before this committee. Can we not cut that out and just make that one change?

Mr. SHANE. I understand your point perfectly, Senator, and the only thing I can say in response without commenting on whether it would be 90 or 85 or some other number is that I will have to return to my Department and seek a special dispensation to do that. I am prepared to ask permission for that kind of a step.

Senator KASTEN. That is a step, and I think everybody can recognize that that is something—maybe if you got tons of unused slots and you are switching flights in and out so that at the end of your 3-month period you can get bumped up back over that threshold so you can fool everybody again—but we all understand what is going on here, and it simply needs to be changed.

Let me just conclude. Later we are going to hear testimony from Mr. Davidoff, and I just want to at this point in the record include one part of his testimony, because it expresses my feelings in many ways:

> Because the time has come for Congress to finish the business of CRS regulation the Department of Transportation is either unwilling or unable to complete. The first regulations were adopted in late 1984, had a planned life of 5 years. Near the end of that time the Government was to reassess the regulations for possible elimination, continuation, or expansion.
>
> Under the latest extension announced by DOT, more than 3 years will have passed before our industry knows what shape the rules will take. In reality, however, we do not expect this deadline to be met, either. We, along with most of our colleagues in the airline and CRS business, have lost confidence in the DOT rulemaking process.

I think it is fair for me to say that I would associate myself with those views and my judgment is that these views would be associated with many of the members of the committee. We have lost confidence in the DOT rulemaking process, and as much as I would agree with you on a kind of a stepping back and looking back at the process, I could not agree with you more about the flexibility that you need.

I feel the same way about us regulating cable television and all these other kinds of things. Technology is moving faster than legislation, and most of these things we do not understand very well. You do, you are an expert at it, and most of the people in the audience do, but because the public and the people associated with this have lost confidence in the rulemaking process, the pressure is now on us, even though it might not be the best way to do it.

You can dig yourself out of this. If you could move on the rulemaking process, we would not be here with this legislation. It is just that simple.

Mr. SHANE. One brief comment. I understand that point completely. The President of the United States has determined that there will be a moratorium on the issuance of new regulations. I support that moratorium completely, and there is really not very much enthusiasm within the administration for going back on the President's word on that.

Senator KASTEN. Mr. Shane, that is a copout. If you did not have the administrative rule thing and the moratorium sitting back here, you would have a different reason. You have been here before without the 90-day moratorium, and we have gone through this.

Now, that gives you one more excuse, and it is a good one because most of us supported the moratorium, but the fact is that the process is one in which the public no longer has confidence, at least in this one area. The public no longer has confidence in the DOT rulemaking process, and you can hide behind the 90-day moratorium.

That is going to be going away soon. My guess is that we could be back here again and there would be no 90-day moratorium, and we would still be arguing about some of these basic things, and I just hope that you can move forward.

Thank you, Mr. Chairman.

Senator FORD. Does anybody else have any other questions that they would like to ask of Mr. Shane?

Thank you for sitting here for a few hours and being bashed. [Laughter.]

If you would respond to your party's desire here, you might not get as bashed as much. You were asked on two or three occasions today to offer some information for the hearing, and I hope you will respond to that fairly quickly.

Mr. SHANE. Yes, sir, we will do that quickly.

Senator FORD. Thank you, Mr. Shane, and I am sure we will be seeing you again.

Mr. SHANE. Thank you, Mr. Chairman.

Senator FORD. Now we have a panel of three: Barry Kotar, senior vice president, Quality Human Resources and Information, Northwest Airlines, Mr. Michael J. Conway, chief executive officer of

America West, and Phil Davidoff, CTC, president and chief executive officer, American Society of Travel Agents.

We will start from right to left. Mr. Conway, if you would start, then Mr. Davidoff and Mr. Kotar, if we could go in that order. We would hope that you would hold your statements to 5 or 6 minutes, and we will include the total statement in the record.

We get here and get a little bit crushed for time, and I do not want to jeopardize the opportunity for my colleagues to ask you questions, and I am sure you are here to answer questions rather than make a statement, so Mr. Conway, if you would proceed we look forward to your statement.

STATEMENT OF MICHAEL J. CONWAY, CHIEF EXECUTIVE OFFICER, AMERICA WEST AIRLINES

Mr. CONWAY. Thank you very much, Mr. Chairman. I appreciate the opportunity to appear before this committee and I had submitted a statement earlier that I would request be entered into the record.

Senator FORD. Without objection your full statement will be entered in the record as if given.

Mr. CONWAY. I will endeavor to be as brief as possible, but I do have some commentary that I would like to put in summary form as well as to introduce some that might be a little bit new.

The underlying premise behind deregulation was to encourage new entrants and provide open access for carriers to come and go into the marketplace as they pleased. The way it is today, it is only a one-way street. Carriers only have the opportunity, in my opinion, to go.

We have an immediate and a serious problem, in my opinion. There is a predator on the loose, and that predator is American Airlines. In my opinion, the entire American Airlines-led fare initiative is nothing more than a disguised strategy in which American Airlines knew exactly what the competitive response of other airlines would be. They were trying to eliminate entirely a niche established primarily by TWA where they had achieved a price advantage in one-stop service over very high-priced nonstop service.

In my opinion, American Airlines knew that TWA would be compelled—once American lowered their fares under a so- called fare simplification program, TWA would first be compelled to drop their fares further to try and maintain a successful niche that they had established. That is exactly where American Airlines wanted them to go, and then immediately went down to those levels.

Along with the massive public relations campaign that started off with fare simplification, American Airlines tried to position themselves as someone who is merely reactionary to lower fares, when all the time they were the protagonist.

Some will argue including, I am sure, American Airlines, that how could this industry not be competitive? All you have to do is look at the staggering losses in the industry. I think when an industry has staggering losses, that is more indicative of an industry's viability, not the competitive nature of the industry, particularly when a few have such market power that they are able to incur large losses themselves, inflict them on people they are supposed to be competing with in a fair manner, and they can in fact

cause the losses to happen and then argue, "My God, we must be competitive."

These same people will tell you, who in my opinion are leading pricing in a predatory manner, that they cannot control their costs. I think that is a very sad statement for any executive to say that they are unable to control their costs, but when you have an industry whose very viability is in question, like this industry is, people who admit that they cannot control their costs, in my view that is the combination that tempts people to cross the line, and I think the line marks fair competition, and that is what puts people over the edge.

I think most people would agree, as evidenced by the participation in this committee hearing today, that something is wrong with the picture in the U.S. airline industry. Something is wrong with the picture any time an industry in just a 24-month period can lose $6 billion, and that happens to be $2 billion more than all of the earnings made by all of the U.S. airlines forever, up until that point.

Now, members of the committee, there is a movie that is being made right now about our industry, and unfortunately I think that movie is very much X-rated. I have heard discussions here this morning about entering into new markets. America West Airlines is the only airline of size that is a survivor of deregulation. I believe we have opened more new markets than any other airline in the United States.

So blatant is the current pricing activity that a large megacarrier airline can one day say they have eliminated corporate discounts and then on that very day in brandnew markets that America West has opened up they are right in the back door of corporations offering deep discounts at a fraction of the fares they previously charged, undercutting our fares, which were made affordable. I think something is wrong when that type of situation is allowed to occur.

I have heard testimony here this morning that a lot of progress has been made in the first quarter, particularly by carriers that you might categorize as in troubled condition, and that is very much the case. I also heard testimony that earnings and improvement for the second and third quarters were uncertain. No, it is not. In my opinion, there will not be any improvement, and there certainly will not be any profitability.

This industry right now has been turned into a game of pure staying power, and the last one with any money left will certainly win. I certainly share the sentiments of the Senator from Missouri. You can go to five of the nine major airlines today and there is a great deal of concern as to the survivability of each one of those airlines.

There are some who might argue that the only reason America West is the lone large survivor of deregulation, those carriers formed since 1978, is because we have been lucky. Well, we have had plenty of luck, but it is not the kind you would like to brag about.

We do not mind competition, and we do not mind hurdles put in front of us. We have an outstanding product. We have the lowest unit cost of any major carrier in the United States. We have got

the best ontime performance of any airline in the United States since the Government began tracking it.

We were 1 of only 2 U.S. carriers that was named in the top 20 in the world as providing the best service to its customers—the other airline was Alaska Airlines—only 2 U.S. airlines, and the U.S. airlines represent more than one-half the available seat-miles in the United States.

As I said earlier, something is wrong with this picture, but I do not think it is too late to do something about it. I would very much urge this committee to work with the Department of Transportation and immediately request the Justice Department investigate what we strongly believe is a predatory condition in our marketplace. I do not think the future bodes well if something is not done soon.

Any time you have people saying they cannot control their cost at the same time they are garnering more and more market share, I believe if the problem is not addressed by the Government now and we do gravitate to two or three very high-cost airlines who claim they cannot control their cost, a much bigger problem will be delivered on the steps of the Government saying we need help.

It has happened before in other industries. You must help us because we are so integral to the overall economy of the United States. You cannot let us fail. You must do something right now. I believe that that is a tragedy that does not have to happen, and again I would urge this committee and the Department of Transportation to request the Justice Department to immediately investigate the current practices.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Conway follows:]

PREPARED STATEMENT OF MICHAEL J. CONWAY

I appreciate the opportunity you have given me and America West to present our views on these very important subjects.

I found it very poetic when I received your witness letter and I read that the subject of the hearing would be the existing competitive practices in the industry and CRS legislation. It is because of unremedied CRS abuses that we have the oligopolistic environment which permits the predatory condition existing today. Anticompetitive CRS practices could have, indeed, should have, been remedied long ago. Had this been done, we would have had an overwhelming net benefit to the public. There would be more airlines in existence and the resultant competition would have instilled efficiencies in the industry that would have brought about sustainably lower fares and a service level at least as good as, if not better than, today's.

Instead, Mr. Chairman, we stand at the edge of an abyss. This is the same abyss into which the U.S. steel and auto industries, once dominant worldwide, have fallen. We face the specter of a consolidated domestic industry with only a few competitors. We face foreign governments renouncing their air treaties with us and preparing to close their borders. If this happens, our largest industry, tourism, will suffer greatly. Economic development, such as that occasioned in Charlotte, North Carolina, where numerous German companies have located, certainly in part due to its existing liberal aviation situation, will be stunted. The great promise of aviation will be grounded.

However, this need not be the case. We can step back from the abyss but we must act quickly and decisively. We must address those anticompetitive practices, CRS being the most important, which result in such an imbalance in the industry. We must also squarely address the predatory conduct recently displayed by a member of the industry and firmly state that it is unacceptable. We must reconfirm the principle that this industry is deregulated and will stay so until the government decides otherwise, not when it suits American Airlines.

In order to fully understand the nature of American's recent pricing initiatives, we must go back and review the pre-April 9th picture of the industry. It was coming

off an eighteen month period where the industry had lost a combined $6B. As has been widely quoted, the combined effects of war and recession had eroded every cent of profit made by U.S. airlines since the dawn of aviation.

However, the news had gotten better if it wasn't actually good. Industry analysts were predicting a small profit for 1992 and better times ahead in 1993. The three carriers operating in Chapter 11 reorganization were making progress based on their public reports. We can only speak for ourselves but we have no reason to doubt the other reports.

I can say with confidence that America West was indeed making substantial progress towards emerging from Chapter 11 in 1992, probably in the 3rd quarter. Key to this progress was our ability to exploit the only competitive tool we have, that being our low cost base. We do not have the CRSs, the slots, the frequent flyer programs, the international routes, in sum the market power possessed by all other full service major carriers. The one thing we do have is a 20 percent cost advantage.

The strategy employed by America West was to find a niche as a low-cost, full service airline. All things being equal, including price, most travelers will take the biggest carriers for a variety of reasons. If we could offer the traveler a slightly lower fare with admittedly fewer amenities, such as private airport clubs, frequent flyer destinations, and the like, we found we could attract enough traffic to eventually prosper. This strategy was working until April 9th.

As virtually everyone knows, American Airlines launched a revolutionary pricing initiative April 9. I will not go into great detail on it but will review a few highlights. From the published reports and unpublished information inside the industry, American's intention was to stimulate inelastic traffic by reducing the full coach fare, which only 5 percent of the traveling public was paying. At the same time they stated they were eliminating corporate discounts and other special fare categories for things like the military, senior citizens and bereavements. Apparently, they maintained special government rates until instructed to discontinue them by the government. At the same time, their "simplification" strategy for leisure travelers was actually a fare increase. Our analysis indicated that their intent was to narrow the differential between the highest and lowest fare, pushing fares into a narrower band, and at the same time realizing a higher average return per passenger. The price for this, however, could be at least $100 million to American by their own admission and $3.5 billion to the entire industry according to other estimates.

The true predatory nature of American's fare initiative soon reared its head. As we adjusted our fares throughout the marketplace in order to maintain our niche, American reacted. They did so in a manner unlike any other carrier. In those markets where we do not compete with American, we did not encounter such irrational behavior.

Let me give the Subcommittee just a few of the numerous examples we have. America West has an extensive Nite Flight complex out of Las Vegas. By using aircraft that would otherwise remain parked at the gate all night, we are able to offer cheaper flights to those individuals willing to fly at night. After the April 9th initiative, we maintained our Nite Flight pricing scheme with an unrestricted one-way fare of $190 between our new hub in Columbus and Las Vegas, as well as between Columbus and Phoenix. In response to that, American slashed their one-way fare, day and night, to $190. Previously, it had been $632. Obviously, this was a little deeper than 38 percent. For us to adopt American's fare plan would mean the end of our Las Vegas Night Flight complex and the consumer benefits it provides. At the same time, American went to BancOne of Columbus, Ohio, which has recently entered into an agreement to purchase Valley National Bank of Phoenix, and offered them a corporate contract for the remainder of 1992 of a $200 one-way fare between Columbus and Phoenix. This was just after their announcement that corporate discounts were a thing of the past. I wonder if the banks in Louisville are getting the same offers?

Not content to nibble around the edges, American next went for the jugular. This was their "50 percent off" sale for summer leisure traffic. In reality, this sale was a 60 percent-off sale in terms of airline revenues because American chose the lowest of the various leisure fares to reduce and, when increased booking fees and commission costs are factored in, you must carry nearly two and one-half people for every one you had planned to carry prior to the sale.

We submit, Mr. Chairman, that any objective review of American's action after April 9th clearly establishes their predatory intent. We know of no industry experts who have stated that this will be a boon for airlines. Northwest Airlines stated that "Some people are more interested in control, control, control of the pricing structure instead of making a profit." Delta Airlines characterized the fares as "unrealistically low." Continental called the action "another irrational fare war." Philip Davidoff, president of the American Society of Travel Agents, expressed what we found to be

a common sentiment of travel agents, "American's action is like nuclear warfare in response to a firecracker. American's broadening of the fare war will be an economic catastrophe for the airlines and for travel agents."

This view is apparently held by securities analysts as well. On June 1, Standard & Poor's downgraded $16.5 billion in securities of four major U.S. airlines; Delta, USAir Group, NWA Inc. and even American's parent AMR Corp. Among the reasons cited for this action was the belief by most airline managements that American's April 9 fare structure will cause a net loss of revenue and that the most recent leisure fare cuts will further dilute revenues, despite a flood of bookings. Last Friday, Moody's Investors Service lowered its rating on $4.6 billion of Delta's long-term debt because of a poor earnings outlook exacerbated by the industry-wide half-price wars. An airline analyst summarized the prevailing view when he stated American had "gone far and beyond what was necessary" and only advances the view that American's real aim is to eliminate capacity by putting weaker competitors out of business.

Even American Chairman Bob Crandall appears to recognize the seriousness of the situation. In a speech to the Wings Club on September 25, 1991, he stated "Unless we can restore our industry's profitability, I have little doubt that we will soon be hearing calls for big-time re-regulation—not only for the reasons we hear today, but also because our increasingly precarious financial situation: threatens the viability of our nation's primary inter-city transportation system; threatens the health of our national economy; and threatens our competitive capabilities in the global marketplace."

In the same speech, he found time to comment on the industry's revenue problems, citing bankrupt carriers as one of the most acute parts of this problem ("whose activities grossly distort product pricing.").

We contend, Mr. Chairman, that this action should be seen for what it is, an attempt to destabilize the U.S. airline industry and put airlines out of business or into bankruptcy. Everyone involved in aviation knows that the summer is the airlines' strongest season. Carriers robbed of profits in the summer face a difficult Fall. More activity such as we have witnessed from American and you face the spectre of tens of thousands of unemployed workers this fall and many more airplanes parked in the desert. And, while these fare reductions may benefit your constituents in the short term, whoever survives the carnage will have to make up the losses and cover their higher costs. This can mean only one thing—substantially higher fares.

This Subcommittee, this Congress, indeed, the entire Federal Government, should state as forcefully as it can, we will tolerate no more of this: Aviation and aerospace are too important to this country to be controlled by one company. Now is the time to deal with this problem while options remain. Much more of this behavior and you will be without options.

One such option is the legislation before the Subcommittee. CRS reform would attack the largest barrier to entry and anticompetitive practice in the airline industry. We have submitted our views on this subject to the Subcommittee numerous times. We first did so in 1987, and what change there has been since that time has been mostly for the worse. The industry has witnessed the disappearance of several carriers and tens of thousands of jobs. Absent pro-competitive governmental action, both of those numbers are likely to grow in the future.

That CRSs convey enormous market power to their airline owners cannot be denied. In its Notice of Proposed Rulemaking (NPRM) on CRS Regulation, 56 Fed. Reg. at 12586 (March 26, 1991), the Department of Transportation (D.O.T.) made the tentative finding that "* * * each of the CRS vendors continues to have market power that could be used to undermine the competitive strength of other airlines in a manner contrary to the antitrust laws. The vendors also have the incentive to use that power to prejudice the competitive position of other airlines." 56 Fed. Reg. at 12591. The D.O.T. made this determination on the basis of the following facts: "[T]here are no perfect substitutes for CRS services available to airlines or travel agencies, each vendor has a dominant market share in some regional markets, and new entry into the CRS business is unlikely." 56 Fed. Reg. at 12593.

This market power is further evidenced by the supra-competitive booking fees the vendor airlines charge their competitors. As the D.O.T. stated, "Each carrier must participate in each system in order to reach that system's subscribers. Moreover, travel agencies have no incentive to choose a system because it has lower booking fees than other systems, for the agencies do not pay the fees, and participating airlines have no way of encouraging agencies to choose the CRS with the lowest fees." 56 Fed. Reg. at 12595.

Another source of market power for the vendor carriers is incremental revenues. As described by D.O.T., "An additional competitive handicap imposed on non-vendor carriers is the vendors' receipt of incremental revenues from their subscribers. In-

cremental revenues are the additional airline revenues a vendor obtains when an agency uses its CRS." 56 Fed. Reg. at 12596. While it is true that some incremental revenues result from perfectly legitimate activity such as sales efforts and customer relations, another significant part of it comes from the way the vendors have structured their CRSs. Again, from the proposed D.O.T. rule, "The vendors' incremental revenues result in large part from their design of their systems, that is, from architectural bias. Architectural bias refers to system features that make it easier and more reliable for an agent to obtain information and make a booking on the vendor than on any participating carrier." 56 Fed. Reg. at 12597.

The legislation before the subcommittee will reduce the market power CRSs have heretofore given their vendor airlines and provide a healthier environment where competition will be based on airline services, not computer bias. The sections of the bill which have been given the label "equal functionality" are designed to lessen, if not eliminate, the architectural bias of the systems. This should stem the flow to the vendors of incremental revenues that do not result from activities connected with the sale of airline services. Incremental revenues resulting from superior sales efforts and the like, should and will remain.

The arbitration provisions in the legislation are necessary to ensure that "equal functionality" is real and not illusory. As has been mentioned previously, vendors have tremendous market power in their ability to charge supracompetitive booking fees to participants. Participants lack any true ability to restrain these fees. They must pay or not participate. This is unique in the airline business. If we want to obtain a plane, a catering contract, or a computer terminal, we have options. If one vendor gives us a price we consider unreasonable, we can shop elsewhere. This is not true with CRSs. We must participate in all in order to remain competitive. The vendors know this and it gives them unsurpassed bargaining power.

Once the requirement for equal functionality has been agreed upon, there must be a way to make sure its attainment and subsequent availability to other carriers is real and not illusory. We see three methods of accomplishing this. The first is to rely upon the beneficence of the vendors. We believe such an approach is unworkable. As has been mentioned previously, vendors have tremendous market power in their ability to charge supracompetitive booking fees to participants. Participants lack any true ability to restrain these fees (D.O.T., D.O.J. and G.A.O. studies all concur on this point). If equal functionality is to have meaning, participants must be able to take advantage of it in a way that is not cost prohibitive. This is particularly true of non-vendor carriers which would include any future new entrants in the airline industry.

The second method is to require arbitration between the parties. This would add balance to an otherwise unbalanced commercial relationship and would give the participants some way to ensure that fees do not rise to the point where it is cost prohibitive to obtain the service. There is simply no other way to ensure this that the vendors do not try to shift to booking fees the incremental revenue they would have received from architecturally biasing their systems. The other choice would be governmental regulation of these fees and that is not an option which America West is prepared to advocate at this time.

Finally, we would like to echo our support for the subscriber contract provisions of the legislation. While we will leave the detailed rationale in the capable hands of friends, the travel agents, we do wish to note that anything which could ultimately lessen the stranglehold particular CRSs have in certain regional markets will ultimately benefit competition and the consumer.

This legislation represents a very modest approach to dealing with the very serious problem of CRS market power. It will minimally interfere with the marketplace, cost the vendors little they claim they are not already planning to spend, and result in enormous consumer benefits in the form of a much needed boost to competition in the airline industry.

We believe that our industry is deeply troubled. Although we do not maintain that a cessation of the recent predatory conduct, coupled with CRS reform, will cure all the ills, the failure to do these things will only worsen the industry's condition.

Senator FORD. Mr. Davidoff.

STATEMENT OF PHIL DAVIDOFF, CTC, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN SOCIETY OF TRAVEL AGENTS

Mr. DAVIDOFF. Thank you, Mr. Chairman. I would ask that the comments that we filed be made a part of the record.

Senator FORD. Without objection, your comments will be placed in the record as if given.

Mr. DAVIDOFF. Thank you, sir.

At the outset, I must agree that I certainly share Senator McCain's concern for obfuscation and delay, and Senator Kasten, I thank you for echoing my testimony as regards the position of the Department of Transportation in the rulemaking.

Very honestly, if the Department of Transportation had done its job, or if we believed that the Department of Transportation would be doing its job in anything that approaches a timely manner, ASTA, the American Society of Travel Agents, probably would not be at this table today, but the fact is they have not done the job and we do not think they are going to do the job.

With respect to hiding behind the moratorium, as soon as the moratorium came out we, along with a number of other industry organizations, asked that the CRS rulemaking be exempted from the moratorium because the purpose of the moratorium was to help small business and was to help the little guy have a chance to succeed in an economic downturn, and that is specifically what the CRS regulations are designed to do, to help the small travel agent—we are small business for the most part—to help us have a relatively level playing field to compete effectively and to give all airlines an opportunity to compete more effectively.

In summarizing our position, there are really three primary areas that we are concerned with more than others: No. 1, that we have conditions that will help sustain a fair, competitive environment in which more than three or four airlines can survive as effective competitors.

We also need the flexibility for travel agents to deal with rapidly changing market conditions, and thereby serve our clients, the traveling public. We are the advocates of our clients. We are their voice here in this room.

Finally, we do support vigorous competition among CRS vendors and we believe that the legislation would foster that competition, giving ample opportunity for all four existing vendors to compete effectively and to provide the best possible service to both travel agents as well as the carriers that they serve.

Removing the burdensome terms from travel agency contracts, things like minimum use clauses, liquidated damages, rollover provisions, will create the flexibility that we need for travel agents to meet continually changing market conditions.

By eliminating artificial obstacles to technical innovation in the marketplace, the continued enhancement of technological creativity will be assured. This is very, very important to us. We believe that the incentive for a travel agency to stay with his CRS vendor should come from a balanced and mutually rewarding business relationship, not from one party's ability to force upon the other party one-sided and unfair terms of dealing.

For that reason, we believe it is vital that the liquidated damages and rollover provisions be eliminated. This will increase the incentive of the CRS vendors to deal fairly and reasonably with travel agents. It will also enable travel agents to be more effective in securing the kinds of technology that we need. We need a lot more ability to access outside data bases not controlled by the CRS

vendors, and to use hardware and software not produced directly by these vendors so that we can be more productive, especially on the leisure end.

The CRS systems as they are currently constituted meet the needs of commercial travel agents pretty well for car rental, air reservations, hotels and rental cars, but they do not really give the leisure agent the creativity and the new tools that we need to be productive and to continue to serve in our market as well as we possibly can.

Despite what you may have heard from the few opponents of this legislation, the Competition Enhancement Act will not prevent CRS systems from having a fair opportunity to compete. On the contrary, the legislation permits market activities that will assure the vendors a fair return on their investment. It will, for example, allow the use of businesslike pricing strategies that reward both travel agencies and CRS vendors when a travel agency makes more productive use of his system.

One illustration of this that I do want to bring to your attention is the use of productivity-based pricing agreements whereby the cost to the travel agent declines from a specific threshold as ticket volume increases and on the other end the price to the travel agent would increase when productivity declines, thus protecting the vendor's investment. We recognize a lot of money has been spent on this. There is a lot of investment there, and we recognize that that investment is very well spent, and we want full resources committed to the travel agent.

Thank you very much.

[The prepared statement of Mr. Davidoff follows:]

PREPARED STATEMENT PHILIP G. DAVIDOFF

I am Philip G. Davidoff, President of the American Society of Travel Agents. ASTA represents more than 10,000 travel agencies that account for more than 16,000 of the 32,000 travel agency locations in the United States. I have owned a travel agency in Bowie, Maryland for 22 years and also own a travel agency consulting and education business. I have served in senior elected positions with ASTA's governing body since 1986, a period which covers the development and evolution of ASTA's present position on the CRS issues now before this committee in the Airline Competition Enhancement Act of 1992.

I am here today because ASTA believes that the time has come for Congress to finish the business of CRS regulation that the Department of Transportation is either unwilling or unable to complete. The first CRS regulations were adopted in late 1984 and had a planned life of five years. Near the end of that time the government was to reassess the regulations for possible elimination, continuation or expansion. Under the latest extension announced by DoT, more than three years will have passed before our industry knows what shape the CRS rules will take. In reality, however, we do not expect this deadline to be met either. We, along with most of our colleagues in the airline and CRS business, have lost confidence in the DoT rulemaking process. Our industry needs answers to the issues posed by CRS regulations and we need them now. We therefore support the prompt enactment of S. 2312, as amended, as a complete substitute for the DoT rulemaking on CRS issues.

The interests of ASTA's members in the subject of CRS regulation can be simply stated:

1) vigorous competition among CRS vendors,
2) the flexibility for travel agents to deal with rapidly changing market conditions, and thereby better serve our clients, the traveling public,
3) conditions that will help sustain a fair competitive environment in which more than three or four airlines can survive as effective competitors,
4) assurance that CRS functionality will not be degraded,
5) an increase in the pressure to innovate the technology of CRS systems,
6) security against damage to the CRS systems,

7) stability, in the sense of a long-term system of rules on which we can count in our business planning and negotiating, and, finally,

8) avoidance of a regime dictated by a government agency that seems to lack the will to resolve the issues that have been pending before it for years.

These interests of travel agents are harmonious with what we believe are the legitimate interests of all CRS vendors and their airline owners. S. 2312, as amended, embodies principles which fairly satisfy both sets of interests.

By removing burdensome contract terms from travel agency CRS contracts, including minimum use clauses, liguidated damages and rollover provisions, the legislation will increase the flexibility of travel agents to meet continually changing market conditions, with benefits to both agencies and consumers of travel services. By requiring equal functionality for all airline participants, more equal competitive opportunities will be created for all airlines and consumer preferences will be satisfied more frequently and with greater certainty. By eliminating artificial obstacles to technological innovation in the CRS marketplace, the continued enhancement of technological creativity will be assured. The establishment of mandatory procedural timetables for enforcement action by DoT will deter violations of CRS rules and will assure timely consideration of complaints in fairness to all parties while eliminating the uncertainty that results from having complaints languish for years without resolution.

The changes in rules governing contract terms are of special interest to travel agents. In the past travel agents have been locked into long term CRS contracts from which there is no practical means of escape even when the conditions leading the agent to select that vendor have changed. When American Airlines was the dominant airline at Memphis, to cite but one example, many Memphis travel agents leased the Sabre CRS system. When American relinquished the Memphis market to Northwest, many of those agents were unable to change to the CRS affiliated with Northwest. Similarly, they could not simply lease a second CRS system without violating the minimum use clauses in their existing contracts. This scenario has been repeated many times around the country as the airline service pattern regularly changes.

ASTA also believes that the incentive for a travel agency to stay with his CRS vendor should arise from a balanced and mutually rewarding business relationship and not from one party's ability to force upon the other party one-sided and unfair terms of dealing. For that reason we believe it is vital that the liquidated damages and rollover provisions of CRS contracts be eliminated. This will increase the incentive of the CRS vendors to deal fairly and reasonably with travel agents. It will also enable travel agents to be more effective in securing the kinds of technology that effective and efficient service to the traveling public requires. Since most of the traveling public looks to travel agents for advice about travel matters, increases in travel agency efficiency, access to accurate and timely information, and equal functionality will produce benefits accruing directly to consumers.

Despite what you may have heard from the few opponents of this legislation, the Competition Enhancement Act will not prevent CRS systems from having a fair opportunity to compete. On the contrary, the legislation permits market activities that will assure the vendors of a fair return on their investment. It will, for example, allow the use of business-like pricing strategies that reward both travel agencies and CRS vendors when a travel agency makes more productive use of CRS services that it leases. One illustration of this is the use of productivity-based pricing agreements whereby the cost to the travel agency declines from a specified threshold as ticket volume increases. On the other end, the price to the travel agent increases when the agency volume declines, thereby protecting the vendor's investment and commitment of other resources to that travel agent.

It is true, of course, that the bill will reduce the maximum contract term for CRS leases by travel agencies, from the present cap of five years to a limit of three years. This change may result in the more frequent negotiation of CRS contracts, but the CRS system that meets the agencies needs for automation should have no difficulty in negotiating renewals. On the other hand, the decision of the travel agency to turn to another vendor will mean that the present arrangements no longer meet the agency's needs. In those circumstances the travel agency should have the flexibility to change vendors in less than half a decade as is now the case.

Under the regime that would be outlined by this legislation, the dominant CRS vendors, Sabre and Apollo, will start with a tremendous advantage in terms of installed locations. They also are very highly regarded by the travel agency community for the quality and reliability of their product. There simply is no credible reason to believe that Sabre and Apollo, and their airline owners, will suffer a competitive disadvantage under this legislation.

ASTA has submitted approximately 100 pages of comments in the DoT rulemaking proceeding, including an analysis of the history of CRS services and an analysis of the state of competition in the airline and travel agency industries as they are affected by CRS systems. Rather than rewriting or duplicating that material in this testimony, we have submitted copies to the Committee staff and ask that this material be included in the record of these hearings.

I will be most pleased to respond to any questions that the Committee may have.

Senator FORD. Mr. Kotar.

STATEMENT OF BARRY KOTAR, SENIOR VICE PRESIDENT, QUALITY, HUMAN RESOURCES, AND INFORMATION, NORTHWEST AIRLINES

Mr. KOTAR. Thank you, Mr. Chairman and members of the subcommittee. I would also ask that the information in the report I submitted be considered a part of the record as well.

Senator FORD. Without objection, your entire statement will be included in the record as if given.

Mr. KOTAR. I appreciate that I am to be allowed to testify today regarding S. 2312.

Northwest Airlines applauds the members of the subcommittee and the sponsors of S. 2312 for your continuing focus on the importance of competition in the airline industry.

Northwest believes that one of the most significant anticompetitive factors in the industry is the current structure of computer reservation systems. S. 2312, which is supported by a broad coalition of airlines and travel agents, effectively and fairly addresses this issue.

This legislation represents the single most effective step Congress can take to promote airline competition and to benefit the airline consumer. In the few minutes allotted to me, I would like to emphasis three points:

First, why the flow of information to the consumer is critical in airline competition, second, how American and United dominate the flow of this information through their CRS's to their competitive advantage, and third, why Congress should enact a standard based on American and United's own representations to require all CRS's to function equally for all carriers.

To compete effectively, an air carrier needs to provide the consumer the most accurate, timely, and reliable information on the best available flights and fares. Travel agents, which sell between 80 and 85 percent of all airline tickets, serve as the neutral distribution system and rely almost exclusively on CRS's, and typically an agent only has one CRS for scheduling, fare, and seat availability information.

American and United both today and historically have controlled over two-thirds of the CRS market. Through a series of subtle manipulations of the computer reservation system, American and United are able to make their CRS's easier to use, more reliable, more accurate, and more secure for reservations made on American and United than on other carriers.

American and United are able to achieve these advantages due to their unique structures—the fact that their internal reservations systems are physically combined with their computer reservation systems. They are known as the hosts. The enormous competitive

importance of being a CRS host was illustrated during Northwest's recent Grownups Fly Free promotion.

Northwest believed that by carefully designing a program tailored to the family, we could put more families on flights who had not planned on flying due to the high cost of air travel. We assumed that some, possibly all, of our competitors would respond competitively by matching our family promotion. Therefore, to gain as much additional business as we could from our marketing initiatives, Northwest filed its new fare on a Tuesday evening, the last moment that the fares could be filed to be displayed in the CRS's on Wednesday.

However, because United is the host of Apollo, United was able to immediately load its matching fares in the Apollo system and to compete directly with Northwest on Wednesday, even though every other carrier had to wait until Thursday for its fares to be loaded into Apollo. Thus, not only was United uniquely able to use its CRS to neutralize Northwest advantage, but also to gain advantage over all other carriers.

Examined individually, each one of the advantages may not seem significant enough to make a competitive difference. Combined, however, the result is that hundreds of thousands of airline reservations will be made on American and United rather than other airlines solely because computers at travel agency locations function better for American and United than for other airlines.

If effective reform is to occur, Congress will need to lead the way. DOT has simply failed to redress the anticompetitive abuses. American has stated that its new and evolving technology will result in a CRS system that functions equally for all participating airlines.

Most significantly, United and American representatives told Members of Congress at a recent demonstration of their CRS's that they could accept legislation setting forth such a standard of equality. Northwest applauds American and United's recognition that the current functional differences in the system must be fixed. However, Northwest urges that Congress not defer action on this important legislation.

Although American and United's planned gradual elimination of these abuses is welcome, there is no incentive for them to do so in a timely fashion. By contrast, they have economic incentive to create new anticompetitive advantages even as they are eliminating the old ones. Legislation is needed to prevent this all-too-familiar chess game.

Adoption of S. 2312 is essential to create a level playing field and to ensure vigorous competition in the airline industry. S. 2312 sets forth a fair and reasonable standard, not technological solutions, that will help address today's abuses and anticipate future problems.

Thank you.

[The prepared statement of Mr. Kotar follows:]

PREPARED STATEMENT OF BARRY KOTAR

Good Morning, Mr. Chairman and Members of the Subcommittee. My name is Barry Kotar, and I am Senior Vice President for Quality, Human Resources, and Information for Northwest Airlines, Inc. For the past 14 years, while at Northwest and previously as President of Covia Corporation (at the time a wholly-owned sub-

sidiary of United Airlines, Inc.), I have been directly and indirectly involved in the operation of airline computer reservation systems—known as "CRSs".

Northwest Airlines applauds the Members of the Subcommittee and the sponsors of S. 2312 for your continuing interest and focus on the importance of competition in the airline industry. As the Members of this Subcommittee are well aware, the past few years have been turbulent for the industry, and the industry has suffered record losses.

After safety and security, Northwest believes that the central focus of U.S. aviation policy should be preserving and fostering competitive balance in the industry. When competition flourishes, the consumer benefits. When competition is diminished, the consumer loses.

To compete effectively, a carrier needs to provide the consumer the most accurate, timely and reliable information on the best available flights and fares. Due to the current structure of airline computer reservation systems, the consumer does not always receive that information. S. 2312, both as introduced and as proposed to be amended, addresses that problem and represents the single most effective step Congress can take to promote airline competition and to benefit the airline consumer.

Northwest believed that S. 2312, as introduced, was the most effective means of redressing the anti-competitive effect of CRSs. However, there was strong opposition to some of the key provisions in that bill.

The proposed amended bill, which is based on American and United's pledge to reform many of the anti-competitive aspects of their CRSs, represents a good, effective compromise. It goes only as far as American and United have stated they will go even without the legislation. However, without a statutory mandate, there will be no incentive for American and United to achieve these reforms; indeed, their true economic incentive will be to delay implementing these reforms for as long as possible and to create new anti-competitive advantages even as they eliminate existing ones.

A broad coalition representing virtually all components of the air travel industry has repeatedly urged the Department of Transportation (DOT) to exercise its power under Section 411 of the Federal Aviation Act and address through regulations many of the issues addressed in S. 2312. This coalition consists of Alaska Airlines, Inc., the American Society of Travel Agents, Inc., America West Airlines, Inc., the Association of Retail Travel Agents, the Aviation Consumer Action Project, British Airways PLC, the Consumer Federation of America, Continental Airlines, Inc., Delta Air Ones, Inc., KLM Royal Dutch Airlines, Northwest, System One Corporation, Trans World Airlines, Inc., and Worldspan, LP.

DOT has been working on this regulation for over 2½ years now, and it is apparent that American and United utterly have stymied the regulatory process at DOT. Indeed, United now argues to DOT that so much time has elapsed that the original record is stale and the Department must start all over again! So we have no hope of reform under existing law. Given these circumstances, we have shifted our focus to legislation.

WHY COMPUTER RESERVATION SYSTEMS ARE IMPORTANT

The computer reservation system is now the primary way that the airline lets the traveler know the cities it serves, its schedule, its fares, and its availability of seats.

Travel agencies, which sell between 80-85 percent of all airline tickets, serve as the neutral distribution system by which airlines reach their customers. They rely almost exclusively on CRSs for scheduling, fare and seat availability information. Almost all travel agencies only use one CRS as their primary sales system. As a result, as DOT once again found last year, CRS vendors have market power over airlines because the carriers are dependent on the CRSs for the distribution of their tickets.

American and United control the two largest CRSs: American is the sole owner of Sabre, and United owns 50 percent of Covia/Apollo; together they control two-thirds of the market. Worldspan, which is co-owned by Delta, Northwest, and Trans World Airlines, and System One (owned by Continental Holdings, Inc.) share the remainder of the market.

WHY AMERICAN AND UNITED HAVE THE LARGEST CRSS

The large CRS market shares enjoyed by American and United today are a direct outgrowth of the large domestic route structures granted to those two carriers by the government during a 40-year period of economic regulation.

CRSs evolved during the same period that Congress deregulated the airline industry in 1978. Al the time of deregulation, American and United bad the largest do-

mestic route structures of any carriers. By contrast, for example, Northwest had a large international route structure, but only a very small domestic presence.

A large domestic route structure was essential to the initial success of a CRS. The American and United CRSs, at the time, were essentially their airlines' own internal reservation systems, with sufficient additional information concerning other carriers flights (such as international routes that they did not serve) to make the system useful for and marketable to travel agents. Therefore, the local travel agent would always prefer to use the CRS of the dominant local carrier, because it was more likely to be selling the most seats on that carrier.

Within two years of the CRS battle being waged, it was over. American and United quickly locked travel agents into their biased systems (which, as will be described below, shifted passengers who may have travelled on other carriers to their own carriers), with contracts that required agents to make more bookings on American and United (often referred to as "minimum use" clauses) and with contracts that extended almost indefinitely (often referred to as "roll over" provisions).

As a result of these practices, American and United have been able to transfer their regulatory power to market power through the use of their CRSs.

HOW CRS USAGE AFFECTS AIRLINE MARKET SHARE

The structure of the current system conveys a competitive advantage for American and United over other carriers, thereby resulting in substantially more bookings on those carriers. The American and United CRSs are physically integrated within their internal reservation systems; they serve as the "hosts" to the CRS and use their CRSs to misdirect passengers onto their airlines from other airlines.

In the early 1980's, the abuse of the computer reservation system by the airline host was blatant. During this period, two flights on two different airlines would be scheduled to leave at the same time, be priced the same, and have the same travel time. However, the CRS vendor would alter the display (referred to as "display bias") so that the host airlines flight would automatically show up first on the computer screen, but the travel agent would be required to scroll through numerous additional computer screens to locate the flight on the other carrier. Because the host carriers flight (which was comparable to the nonhost carriers flight) met the customers needs, there would be no reason for the travel agent to search for the other flight. As a result, the customer or travel agent never even considered the alternative service. Fortunately, rules issued by the Civil Aeronautics Board in 1984 banned this harmful practice.

Prohibited from directly biasing the display of their systems, CRS vendors sought to preserve the benefits of display bias through a series of subtle manipulations of the systems to make them easier to use, more reliable, more accurate and more secure for reservations made on the host carrier than on other carriers.

On American and United, a travel agent will consistently have the most recent information on the availability of seats, can instantly confirm reservations, and can issue boarding passes and assign seats on the host carrier. These advantages are not always available to other carriers. In addition, the host carrier has direct and consistent access to valuable travel information such as the passenger name record (PNR) (which contains pricing and frequent flyer data) and can immediately load its own fares and schedules into the CRS; again, these features are not always available for other carriers.

When you own the ballpark (the CRS). you can get on the field (display new fares) whenever you want: The enormous competitive importance of being a CRS host was illustrated during Northwest's recent "Grownups Fly Free" promotional program. Northwest identified an important segment of the market—the family—where the demand for air travel had been exceptionally low. Northwest believed that by carefully designing a program tailored to the family, we could stimulate additional demand. The goal was to put on flights families who had not planned on flying due to the cost of air travel.

We assumed that some—probably all—of our competitors would respond competitively by matching our family promotion. Therefore, to gain as much additional business as we could from our marketing initiative, Northwest filed its new fare with the Airline Tariff Publishing Company (ATPCo.) the last moment—7:00 pm. on Tuesday evening—before the deadline for fares to be displayed in the CRS on Wednesday. Ordinarily, this would give Northwest a one-day jump on the competition, whose matching fares could not be submitted until Wednesday for display on Thursday.

As expected, Northwest did gain a jump on all of its competition—all except United. Because United is the host for Apollo, United was able immediately to load its matching fares into the Apollo system and was able to compete directly with North-

west on Wednesday. As a result, even though United and most other carriers decided to match the Northwest program on Wednesday, United was able to sell the new fares through Apollo immediately, while every other carrier had to wait a day for its fares to be loaded into Apollo. Thus, United not only was uniquely able to use its CRS to neutralize Northwest's advantage, but also to gain an advantage over all other carriers.

WHEN SUBTLE DIFFERENCES RESULT IN ENORMOUS COMPETITIVE ADVANTAGES

There are a myriad of subtle advantages for the host carrier over the nonhost carrier which will affect the professional travel agent, who is always seeking to provide the customer the best possible service. Examined individually, each one of the host advantages, examples of which are more fully set forth in Appendix A,[1] may not seem significant enough to make a competitive difference. Combined, however, they result in a substantial advantage to the host carrier. The result—known as "functional bias"—is essentially the same as display bias: hundreds of thousands of reservations are made on the host airline rather than other airlines as a result of the computer bias.

A hosted CRS:

- shows the correct number of seats remaining on a host carrier flight, while for other carriers it often shows only a "0" or an arbitrary number that does not always accurately reflect the number of seats remaining;
- rarely rejects updates to passenger information (such as name or itinerary) for host carrier flights, but may reject such an update for another airline for a variety of reasons;
- is often able to show more classes of service (such as different fares) for host flights than for flights on other airlines;
- identifies host carrier flights that have additional flight information and readily provides such information, while flight information for other airlines is not always highlighted;
- immediately accepts or rejects a booking on a host flight, while a request for seats on a nonhost airline may not always be confirmed or rejected immediately;
- may permit agents to use special codes to request host carrier services, such as wait-listing priority, but may not provide the same ability for the flights of other airlines;
- provides seat map displays for host carrier flights, but generally requires that an agent directly access a nonhost's own system to display that carrier's seat maps;
- immediately confirms seat assignments on host flights, while for other airlines this process is much slower and may require the agent to retrieve passenger data to confirm the assignment;
- retains an existing seat assignment for a host passenger that is rebooked in a different class of service, while often dropping the seat assignment of a nonhost passenger who changes service class; and
- creates records of passenger information for the CRS and the host airline which always are compatible, while a nonhost passenger record may be incompatible with that maintained by the CRS and may result in confusion.

As a result of all of these functions, a travel agent can provide a higher quality service to his or her customers on the host carrier than on a non-host carrier, and this service can be achieved more efficiently as well. Consequently, hosted systems result in hundreds of millions of dollars being shifted from non-host carriers to host carriers.

When an "unavailable" seat is available:[2] A day-to-day example also will help illustrate the subtle, but important, advantage that accrues to the host carrier.

Assume that a customer wants to fly from New York to San Antonio on a discount fare. The customer calls a travel agent who uses a Sabre system, but the customer does not know that nor does he know that the Sabre system biases in favor of American. The system shows that there are two flights around the time required: one on Continental and one on American. The customer enjoys flying both carriers and is indifferent as to which one he uses this time. On American, the display may show that there are 3 seats available. (Sabre will always carry the most recent and accurate information concerning American's seat availability.) On Continental, the display shows that there are no seats available. This is inaccurate, however, because at the time of the booking inquiry Sabre does not have the most recent and accurate

[1] Appendix A contains examples of host advantages prepared by Northwest and submitted last summer to the DOT in the pending CRS rulemaking.

[2] Diagrams of the process of determining seat availability and seat selection are attached as Appendix B.

information concerning Continental's seat availability. The travel agent in fact knows that there is a possibility that there are still seats available on Continental at the same fare. However, the agent must decide whether to take additional steps and expend additional valuable time to determine the actual availability on Continental. In this case, there would be no reason for the travel agent to undertake this additional effort because American was offering a flight at a price that was acceptable to the customer.

As a result, even when Continental is offering a fully competitive alternative to American, the customer may never end up making a decision between the two carriers because he is unaware that there was a choice.

In short, on the American and United CRSs, which constitute two-thirds of the market, it is easier, more reliable, more timely, and more secure for a travel agent to make a reservation on American or on United, than on other carriers. As a result, hundreds of thousands of airline reservations will be made on American and United rather than on other airlines solely because computers in travel agent locations function better for American and United than for other airlines.

HOW AIRLINE COMPETITION IS AFFECTED BY CRS USAGE

The shifting of passengers described above need not be statistically large to have a huge anti-competitive impact: In 1991, travel agents booked over $29 billion on American's Sabre system and United's Apollo system. Therefore, if those two carriers shift even 1-2 percent of the travel from other carriers to their airlines, it will result in their receiving hundreds of millions of dollars in additional revenues (often referred to as "incremental revenue").

This anti-competitive impact of the computer reservation system industry is well-documented. DOT, in a comprehensive study in 1988, found that CRS ownership by American and United resulted in those carriers receiving over $400 million in 1988 in incremental revenues (Department of Transportation, Study of Airline Computer Reservation Systems, May, 1988, Table 4.2 ["DOT Study"]) taken directly from the bottom line of other carriers. This figure was in addition to the $400 million they collected in booking fees that year (DOT Study, Table 4.12), which DOT found were far in excess of costs: 192 percent above cost for Apollo and 233 percent above cost for Sabre (DOT Study, Table 5.9.) Such transfers, year after year, have added immeasurable financial strength to these airlines at the expense of the rest of the industry.

Over eight years after the government began looking at these systems, the harm persists. During this period, there have been numerous reports and studies by a variety of governmental bodies—the Department of Justice, the Department of Transportation, and the General Accounting Office—and every one has concluded that CRS ownership by American and United is harmful to competition. In short, the single biggest mistake in implementing airline deregulation was to allow carriers to own and operate CRS systems or the failure to neutralize these systems once established.

WHY CONGRESS NEEDS TO ACT

If effective reform is to occur, Congress will need to lead the way. The current CRS rules have not prevented the dominant carriers from using their CRS market power to advantage their own airline operations. CRS rules were last issued in 1984; since then United and American have found innovative ways to circumvent the rules. According to the Department of Justice:

> "The current CRS rules have not been successful in preventing the CRS vendors from exercising their market power in ways that substantially harm air transportation consumers."

Department of Justice, ANPRM Comments, November 22, 1989 at 33.

Furthermore, DOT has failed to issue new CRS rules. Recognizing that the current rules ware insufficient to prevent new abuses, DOT began a new rulemaking in 1989. Yet DOT has repeatedly missed every one of its own deadlines (December 31, 1990; November 30, 1991; and May 31, 1992), and has continually delayed issuing a final rule. Only last month DOT once again delayed the final rule, extending the current rules until at least December, 1992.

In addition, the new rules currently proposed by DOT are unlikely to have any significant impact on the fundamentally anti-competitive effect of CRSs. Prior to the original rules in 1984, the most pervasive problem was display bias—CRS hosts designed the system so that their flights would show up first. The 1984 rules effectively eliminated that type of abuse. After 1984, the American and United CRSs still provided a competitive advantage to their host carriers—the systems functioned more effectively for reservations made on those two carriers. This "functional bias"

remains today, and DOTS proposed rules fail to address this pernicious practice. Also, DOT indicated that it will not address one of the more egregious deficiencies in the current system—the level of booking fees—claiming that it is impracticable and inefficient to regulate the fees even though, as a practical matter, each carrier must have its flights listed on each CRS system.

WHY CONGRESS SHOULD ENACT S. 2312

Northwest believes that the best and most direct way to address current and future CRS abuses—short of divestiture—is to eliminate the structural or host advantage and to require that the CRS and the airline's internal reservation system be physically separated, thus being operated as a "No-Host" system. Worldspan (partially owned by Northwest) is committed to becoming a No-Host System. As the Subcommittee is well aware, the original S. 2312, strongly supported by Northwest and others, required that CRSs become No-Host Systems by 1994. However, American and United and some Members of Congress opposed legislation requiring a No-Host system.

Therefore, Northwest and other members of the air travel community sought a solution that would redress the anti-competitive harm caused by the functional bias of hosted CRSs. We believe a reasonable compromise has been adopted in S. 2312, as proposed to be amended, which reflects American's offer to adopt a system free from functional bias.

Last summer, in pleadings before DOT, American announced that its "seamless connectivity" technology would result in a CRS system that functioned equally for all participating airlines. American stated:

> "Government should not mandate technological solutions in any industry. If DOT must adopt a rule, it should simply require that vendors expeditiously make available to all participants—in any way they choose—completely equal functionality for all.
>
> * * * * *
>
> "Seamless connectivity will provide all CRS systems with real time linkage to all airline reservations systems, and will permit any user of any CRS to make inquiries or inputs into any airline database without any more keystrokes than are required for the host airline. Moreover, the data reviewed in response will be equally fresh and accurate for all carriers. This will make the CRS transparent to the travel agent, so that all airlines will effectively be hosts.
>
> * * * * *
>
> "American estimates that seamless connectivity can be created by each vendor at a cost of not more than $10 million and in not more than two years."

American Airlines, Reply Comments, Docket 46494, Department of Transportation, August 12, 1991 at 4, 6, and 7.

As recently as this spring, American reaffirmed its support for equal functionality. Again, in pleadings before DOT, American stated that other carriers

> "can achieve absolutely equal functionality in the display and sale of their product through the use of seamless connectivity and other technological innovations. Moreover, American committed at that time to eliminate [by February, 1993) any residual differences in the way SABRE handles American's services as compared with the services of other airlines. Fulfillment of that commitment is on schedule."

American Airlines, Supplemental Comments, Docket 47978, Department of Transportation, March 2, 1992 at 7.

On March 10, 1992, CRS vendors, including American and United, displayed their systems to Congressional Members and Staff. During that demonstration, American and United representatives stated that, within the next year, their systems will achieve equal functionality, without resorting to No-Host. Most significantly, in response to questions by the Members, they stated that they could accept legislation requiring equal functionality if it did not include a "no-host" requirement.

Based on these representations, sponsors of CRS legislation both in the House and in the Senate revised their original CRS bills. S. 2312, as proposed to be revised, no longer contains the No-Host component objected to by American and United. The legislation requires only that it be as easy, reliable, timely, and secure to make a reservation on one airline as on any other airline listed in a CRS—the standard that American and United have stated that they are planning on achieving even without the legislation.

Northwest applauds American's and United's recognition that the current functional differences in the system must be fixed. However, Northwest urges that Con-

gress not deter action on this important legislation based on American's and United's representation that they are working to achieve equal treatment for all airlines. Unfortunately, American and United have a long history of biasing their systems, either through display bias or functional bias, to their advantage. Although their planned gradual elimination of these abuses is welcome, there is no incentive for them to do so in a timely fashion. They have stated that these reforms will be complete in 1993—but there is nothing to ensure that this timetable will not slip until 1995, or 2000 or beyond. Indeed, their true economic incentive is to delay as long as possible to reap the greatest possible benefit from their current advantage. Moreover, they have an incentive to create new biases as they are eliminating existing ones. Legislation is needed to prevent this all too familiar chess game.

Adoption of S. 2312 is essential to ensure vigorous competition in the airline industry. S. 2312 sets forth a fair and reasonable standard—not specific technological solutions—that will help address today's abuses and anticipate future problems.

WHY OTHER PROVISIONS IN THE BILL ARE IMPORTANT

In addition to the functionality requirements, the legislation has other important provisions that Northwest fully supports.

First, the bill provides travel agents important protections against onerous contract provisions and other practices which make it prohibitively expensive for most agents to switch to another CRS based on a free market decision.

Second, the bill establishes a procedure, with firm deadlines imposed on DOT (similar to those used for route cases) to ensure that disputes concerning the bias and functionality of a CRS are resolved in a timely manner on the merits.

Third, the legislation provides that new or increased booking fees be subject to private arbitration. Because airlines are dependent on the CRSs for the distribution of their tickets, they have to pay whatever the CRS vendor charges for that service. Unreasonably high booking fees to participating airlines distort airline competition and add to the costs that must ultimately be borne by consumers. The arbitration provision, like many private contractual provisions, simply requires that the parties submit disputes to private arbitration and that fees be reasonable, including a reasonable margin of profit.

Fourth, the legislation includes a provision requiring DOT to ensure that a sufficient number of slots are available for Essential Air Service carriers. Northwest is aware that small communities have had problems accessing the national air transportation system with scheduled service to a major hub, particularly if that hub is slot-restricted. We support the provision in S. 2312 to ensure that there are sufficient slots for EAS carriers.

CONCLUSION

Al a time when many in Congress, federal policymakers and consumers are concerned about the level of competition in the airline industry and the number of airlines that will survive this turbulent period, S. 2312 is the single most important step Congress can take to improve airline competition. We strongly urge Congress to adopt it as soon as possible.

APPENDIX A

Computer Reservation Systems Provide Travel Agents Numerous Indicia of Host Carriers' Advantages Over Participating Carriers [1]

Host carriers	Nonhost carriers
Availability displays: The primary display shows any number of seats, from 0 to 9 (0 to 7 on Sabre), as available for a host carrier flight.	For nonhost carriers, the seat availability is shown either as "0" or one other number (typically 4).
The primary display shows a maximum of 8 classes of service. A secondary entry may display additional classes for host carriers.	No additional classes of service are shown for nonhost carriers.
The display may indicate that flight information ("FLIFO") exists for a host carrier flight. The agent can display this information by making another entry.	Nonhost flights display no indication of FLIFO.

Computer Reservation Systems Provide Travel Agents Numerous Indicia of Host Carriers' Advantages Over Participating Carriers [1]—Continued

Host carriers	Nonhost carriers
An agent may be able to display amenities on host flights*.	Nonhost flights do not display information on amenities.
Other flight information: Flight service information for host flights includes mileage*.	Nonhost flights do not show mileage.
FLIFO is provided for host flights. It details scheduled times and nonroutine operations..	FLIFO for nonhost flights is provided only with a Direct Access function.
Reservation of space: When an agent requests a reservation on a host flight, the CRS will respond either with a rejection, because the space was not available, or with an acceptance. If the request was accepted, the response will include the status code "SS" indicating that the space was sold after availability was checked. Because the host inventory was checked and decremented at the time of the original sale, the reservation will not be rejected when the agent subsequently files the passenger name record ("PNR"). When the agent redisplays the PNR, the status code "HK" will appear, indicating that the space is confirmed.	When an agent requests a number of seats on a nonhost flight equal to or less than the number shown as available (typically 4), the response will include the status code "SS" and immediate redisplay of the PNR will show an "HK" status code. However, it is possible that when the nonhost airline receives the request (typically seconds after the agent files the PNR), it may reject the request because its inventory shows the flight as full. In this case, it will send a message to the CRS which will cause the status code to be changed to "UC" or "US," indicating that the space is not reserved. When an agent requests more seats on a nonhost flight than are shown as available, the response will include the status code "NN," indicating that the space will be requested. This code would not be seen for a host flight. When the nonhost airline receives the request, it replies with a message indicating whether or not the request was accepted and changing the status code accordingly. When the agent redisplays the PNR, the "HK" status code will not appear; rather, the status code will indicate either that the CRS is awaiting a reply from the airline or that the booking request was accepted or rejected by the airline.
Updates to host carrier PNRs rarely are rejected	When an agent updates or files a PNR containing nonhost bookings and quickly begins to make another update to the same PNR, the second update may be rejected if the CRS itself is updating the PNR in response to booking information sent by the nonhost airline.
An agent may be allowed to use nonstandard status codes for host flights to request special services (e.g., priority in waitlisting).	Agents generally may not use special status codes for nonhost flights.
A response to a request to book a host flight may have additional flight information appended.	Responses to nonhost booking requests do not contain additional flight information.
Seat assignment and boarding pass printing: Seat map displays for host flights are available	Only nonhost airlines with Direct Access will have seat maps available.
When a seat assignment is requested on a host flight, the request is immediately confirmed if the seat is available; otherwise, a seat map is displayed. With the same entry the agent also may request that a boarding pass be printed.	Seat assignment requests for nonhost flights require the agent to wait for a response to a PNR (this may take seconds or much longer). The agent then must retrieve the PNR to determine whether the request was accepted. Thereafter, the agent must then request that the boarding pass be printed.
An agent can request a host seat assignment for any number of passengers in a given PNR.	An agent reserving nonhost seats must request a seat assignment for all passengers listed in the PNR at once.

( ) Fra merous indicia of
/ [1]—Continued

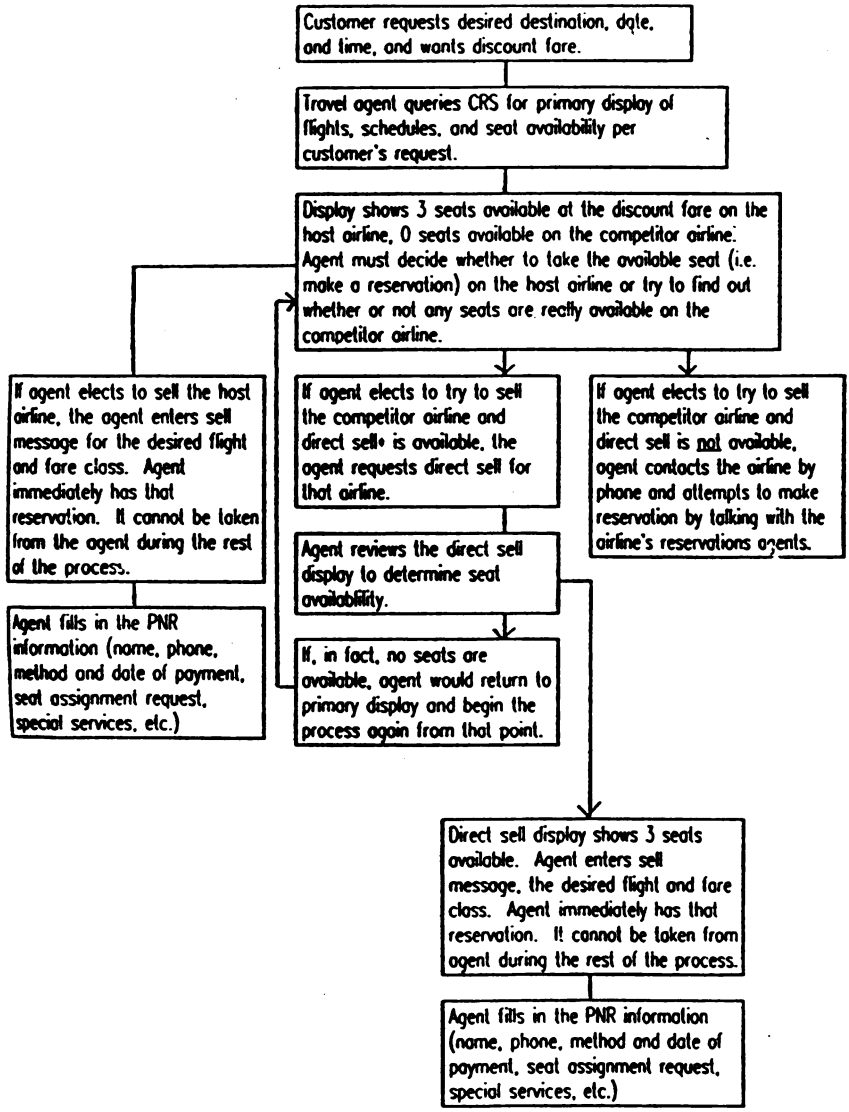
Host carriers	Nonhost carriers
A passenger on a host flight who requests that frequent flyer mileage be credited to an account with another airline (pursuant to an interline agreement) will receive a boarding pass showing the frequent flyer number of the other airline*.	Boarding passes for nonhost carriers will not show quent flyer number of a second, nonhost airline
A travel agent can review changes (such as seat assignments or boarding passes printed) made to a PNR by the hosts' airport agents.	PNR changes made by nonhost airport agents c reviewed by the travel agent.
If an agent rebooks a passenger in another class within the same cabin on a host flight (e.g., to obtain a cheaper fare), the existing seat assignment will be retained.	Agents rebooking in another class on nonhost fl lose their existing seat assignment. Automatic r provided for host flights may be restricted if PI tain nonhost seat assignments.*
Passenger name record (PNR) display:	
FLIFO text for host flights appears under the flight item in the PNR display.	FLIFO for nonhost flights will not appear at a co place in the PNR display.
PNR changes made by host airlines will always appear.	PNR changes made by nonhost airlines appear certain standard circumstances.
PNRs can always be retrieved by specifying a host flight in the PNR and the passenger's name.	PNRs containing nonhost flights may not be well-i
PNRs containing host flights will show certain status codes for reservations affected by schedule changes.	Nonhost flights displayed in PNRs will show diffe tus codes to reflect schedule changes.
The PNRs maintained by host airlines and subscribers are almost always compatible.	Separate PNRs maintained by the CRS and the airline may be incompatible, requiring agents the damage before making or altering bookings.
Other differences:	
Agents may save keystrokes by indicating that a host airline code is to be used*.	Nonhost bookings may require more keystrokes.
When ticketing on a host airline, agents are notified whether the host accepts a particular credit card*.	If the host does not appear in the PNR of a mu itinerary, the CRS will not confirm the exis interline agreements.

[1] This chart describes differences in host/nonhost functionality for both PARS and Sabre. Comparisons which do not apply are marked • , and those Northwest was unable to confirm for Sabre are marked *.

APPENDIX B

Seat Availability Example

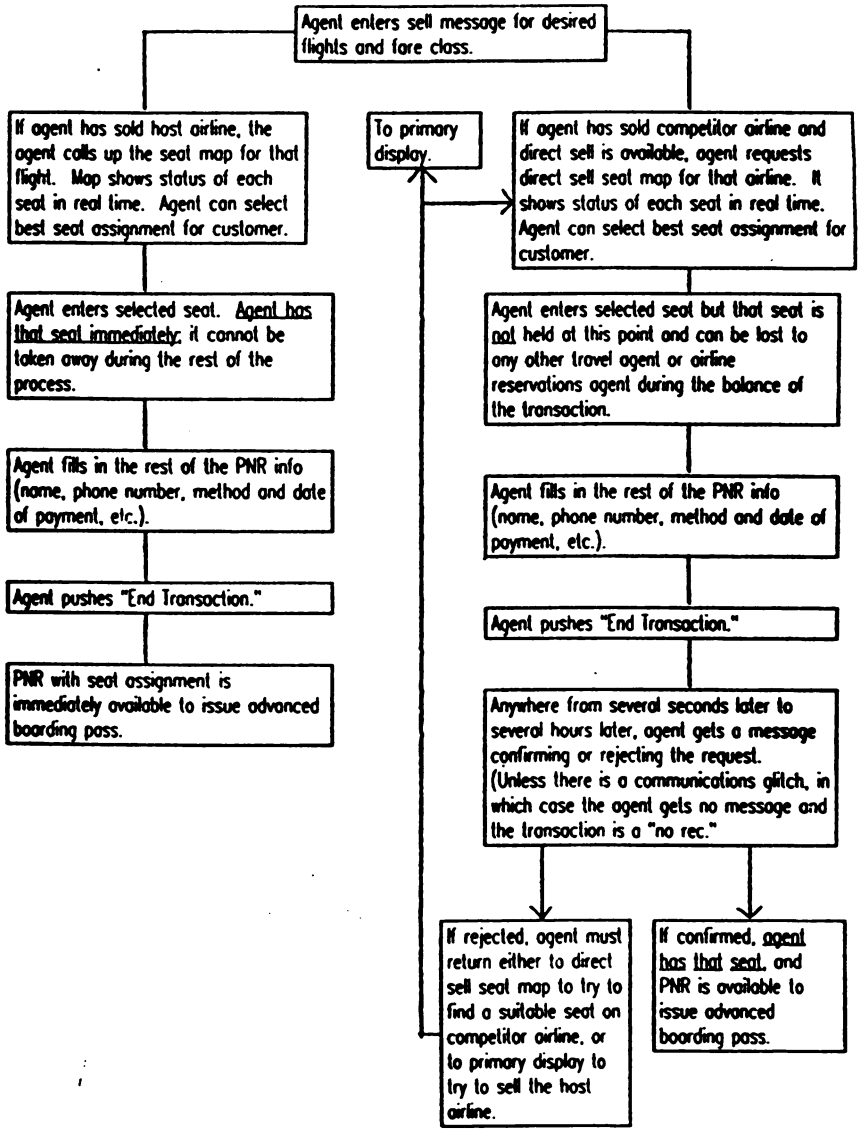
Both airlines have 3 seats available to requested destination at desired time and fare class.



*As used in this example, "direct sell" refers to a service which allows an agent both to look at information and book reservations. If the service available is at a lower level, then selling the competitor is even less attractive.

Seat Assignment Example

(Customer wants a particular seat e.g. bulkhead, aisle or row number.)



Senator FORD. Thank you, gentlemen.

Mr. Conway, and work across. Mr. Conway, you

Pan Am, and Eastern? Do you think America West could have avoided bankruptcy on account of CRS?

Mr. CONWAY. No, Mr. Chairman, I do not believe that a fix to the CRS system would have been all things to all people, but I do believe it was a significant contributor for carriers who were unable to achieve viability. To your point, would fixes in the CRS system have resulted lower fares, and I assume then a better deal for the consumer, I believe so.

Before some of the biases were fixed——

Senator FORD. Are you saying some of the biases have been fixed?

Mr. CONWAY. Yes, but we have a ways to go in terms of who gets displayed first. Prior to action that was taken to remove some of these biases, the carrier that was displayed first was the host carrier. That was later fixed to whoever provided the nonstop service by displays to elapsed time, but in most cases the service provided by the host carrier was the more expensive of the alternatives being offered, and the time constraints and difficulty to search out the most affordable fare and therefore the best deal for the consumer was lost, so yes, I do believe people paid a lot more money than they otherwise would have had to if there was pure objectivity in the system.

Senator FORD. What are the supracompetitive booking fees you referred to?

Mr. CONWAY. Well, the booking fees——

Senator FORD. You said supracompetitive.

Mr. CONWAY. I do not recall supercompetitive.

Senator FORD. Well, what did you mean, then, by booking fees that you referred to? Let me just ask you this: How do your annual booking fees compare with other annual costs such as travel agent commissions?

Mr. CONWAY. They are not as high, but that does not mean that we are comfortable with their levels. The booking fees are not as high as our fuel bill, either. I am not happy with the fuel bill, either. But they are substantial. They are in the several millions of dollars, and by way of example, this recent fare initiative which I have stated earlier is clearly predatory, it did result in a surge of bookings, albeit at price levels that I think have a less than ideal motivation behind it.

We will pay probably a couple of million dollars in just booking fees for the sales that were generated by this recent action, and it is somewhat ironic that the airline that I believe is the predator is on the positive receiving end of those very booking fees for an artificial and abnormal condition which they created.

Senator FORD. Am I correct that Sabre charges $2.15 per booking?

Mr. CONWAY. That is approximately correct.

Senator FORD. What is the commission, then, for the travel agents?

Mr. CONWAY. The standard commission is 10 percent without overrides.

Senator FORD. What is an override?

Mr. CONWAY. An override is an additional commission that is paid to certain agencies based upon the volume of business that they might do with a particular carrier.

Senator FORD. That goes back to old J.C. Penney days; does it not? You set a level, and if you go over that level you get a higher commission. So, $2.15 is approximately right for a booking from Sabre—10 percent of that ticket goes to the agent, and if they go to a higher figure or an agent is doing well that you would like to bring into yours, you may pay them a higher commission rate.

Mr. CONWAY. That is correct, Mr. Chairman.

Senator FORD. I understand that in the fall of 1990 America West had almost $3 billion of aircraft on order when it entered into an agreement to acquire another $2.5 billion. How did you expect to support that level of debt?

Mr. CONWAY. Senator, a great deal of those orders were spread out over a 15-year period, and when taking into account what the stream of aircraft into our system would have been over a 15-year period and the retirements of older equipment that we had planned, that stream of new equipment coming in was no greater—in fact, it represented less of additional equipment coming in than in our first 7 years of operations.

We made a conscious decision to provide service with a modern fleet. We do not enjoy some of the noncompetitive franchises of others. One of the major reasons why we have achieved the lowest cost of any full service carrier in the industry is because we operate the most modern fleet in the United States, and therefore it is the most fuel-efficient fleet.

That order simply was to maintain the edge that we have in providing modern, fuel-efficient air transportation. A great deal of that order that you referred to, the financing was already locked in at what I believed were the most competitive operating lease rates that existed in the industry at that time.

Senator FORD. Since America West has been under protection of the bankruptcy court, Mr. Conway, what costs have you been relieved of paying?

Mr. CONWAY. In fact, Mr. Chairman, we have really not been relieved of paying any costs. As I know you are aware, one of the protections that you have is the timeliness in which you pay your obligations back. It is not an automatic forgiveness. But the cost of providing air transportation, our daily operating costs, there were no costs that we were relieved of.

In fact, operating under chapter 11 in my view, now that we have been in it for almost 1 year, clearly provides no operating cost advantage and as has been the case with other carriers who have sought protection under chapter 11, we are averaging approximately $800,000 to $1.2 million per month in additional costs that are associated with fees connected with the process, so I see no advantage.

Senator FORD. What additional fees would you have as a result of bankruptcy? I thought you would delay payments on some things.

Mr. CONWAY. The fees I am referring to, Mr. Chairman, are more [illegible] fees and advisory fees than I have ever known could be pos-

Senator FORD. So, you went into bankruptcy, you hired another set of lawyers?

Mr. CONWAY. Another set would be a significant understatement.

Senator FORD. Well, anyway, the extra cost then is not—you refer to a fee as a legal fee, rather than additional costs.

Mr. CONWAY. Right, a nonoperating cost. If I could, Mr. Chairman, there are also other additional operating costs that a reorganizing carrier incurs. Obviously, the stigma associated with chapter 11 is not one that you would rave about. In order to maintain consumer confidence as well as to combat the innuendoes that come from nonchapter 11 carriers additional sales forces are necessary, more focused and additional advertising is necessary. I have seen absolutely no advantage from an operating side under chapter 11.

Senator FORD. Mr. Kotar, let us get to you for a minute. Your testimony traces the development of the CRS back to the late 1970's. Why did Northwest not invest in CRS technology then?

Mr. KOTAR. Well, I have only been with Northwest for a few years.

Senator FORD. You know the history of it, I am sure.

Mr. KOTAR. I think it was as much a function that people did not understand the importance of CRS and how, in fact, the distribution channel had changed from basically using paper books that the travel agents used to electronic means, and then coupled with the fact that deregulation occurred.

Senator FORD. So, some understood the electronic media or electronic procedure and others did not, is that what you are saying? Some took advantage of it?

Mr. KOTAR. Some took advantage, others did not. That is correct.

Senator FORD. You state that arbitration of booking fees is necessary to prevent CRS owners charging unreasonably high fees. Do you believe the fees are unreasonable now?

Mr. KOTAR. No, we do not. We do have a question, though, about the way Covia has recently devised a price structure where they have unbundled their pricing. It is questionable, because in fact they quoted that the effective price increase would be 8 percent, and we believe it is much greater than that.

Our concern, sir, is that as we go into the future, we do not know how these prices might change. We believe that, while we might be able to use litigation to get relief on any price increase, we believe that the methodology for arbitration makes much more sense.

Senator FORD. What percentage of Worldspan does Northwest own?

Mr. KOTAR. Thirty-two percent.

Senator FORD. So, you own one-third of it.

Mr. KOTAR. That is correct.

Senator FORD. And that is a CRS booking firm; is it not?

Mr. KOTAR. Yes.

Senator FORD. Your testimony asserts that American and United will have no incentive to continue to reform the CRS to eliminate bias, yet reforms and improvements have been made consistently without legislation and with limited regulation. Why are you so convinced that legislation is needed to do what the CRS owners are

moving toward anyway? I mean, since you are an owner of one now.

Mr. KOTAR. I think the point made by Senator Lieberman spoke to it, and that is the fact that the Department of Transportation has refused to take any action. I outlined in my testimony a case in point recently where Northwest filed a fare program which, had the fares been entered into the system through the normal process, Northwest would have had an opportunity for a 1-day advantage, but because of the fact that United is the host of the system they were able to take an unfair advantage of it, and——

Senator FORD. I do not quite understand how you own a piece of a CRS and United owns a piece of a CRS and they get the big advantage and you are beating on them here this morning, and yet you are a part of that system yourself.

Mr. KOTAR. Sir, Northwest, Delta, and TWA have agreed with Worldspan to develop a no-host system. The no-host system will totally separate the airlines' internal reservation system from the CRS and eliminate——

Senator FORD. You do not have it now, the agreement; do you?

Mr. KOTAR. No, but these rules state that they will go into effect in a few years when we will have it.

Senator FORD. A few years from now.

Mr. KOTAR. I believe the rule says 1994.

Senator FORD. Well you state that S. 2312 is the most important step Congress can take to assure airline competition and survival; is that correct?

Mr. KOTAR. Yes.

Senator FORD. All right. I happen to think the DOT should have taken steps to disapprove some mergers to limit the carrier debt acquired through leveraged buyouts and to award international routes through a public process rather than sale. Do you believe DOT's actions in these areas have helped competition?

Mr. KOTAR. Sir, I am a CRS expert. If you need someone from Northwest who can speak more definitively on those points, we will have to get someone else for you.

Senator FORD. Well, you know, you are the senior vice president for quality, human resources, and information.

Mr. KOTAR. That is correct.

Senator FORD. Mr. Davidoff, you expressed concern over the possible bias in the CRS which is owned by an airline such as Sabre System which is owned by American Airlines.

Mr. DAVIDOFF. Yes.

Senator FORD. Can a travel agent change a CRS program to create a bias in favor of a particular airline?

Mr. DAVIDOFF. Not easily.

Senator FORD. Is there any restriction to prevent travel agents from doing this?

Mr. DAVIDOFF. A travel agent today could set up his system to bias a carrier, but we believe that should only be done when a specific client tells the agent, "my preference is to fly on Northwest, therefore, I want your agents to give me Northwest flights first time out." I believe the agent should have the ability to and currently they do have the ability to set the system for that client to bring up the Northwest Airlines first for that client.

I think that has to be based upon client demand, not agent demand, because our industry prides itself on setting the needs of the traveler first, not dictating to the traveler what airlines he should fly on. S. 2312 would permit an agent to bias displays when the customer requests it, subject to very specific restrictions. The bill prohibits general biasing of an agent's CRS displays.

Senator FORD. This legislation would establish procedures for arbitration of booking fees because some airlines believe CRS owners charge too much, that is the purpose of it.

I would think travel agents' commissions cost the airlines much, much more than booking fees.

Mr. DAVIDOFF. Obviously.

Senator FORD. So, about 10 percent, 1 percent roughly. Should there be a system established to arbitrate travel agent's commissions if airlines believe they are too high?

Mr. DAVIDOFF. I believe that should be in the marketplace. Travel agents do not have market power with respect to commissions. Every Government study of CRS says that the CRS vendors do have market power over booking fees. The two situations are fundamentally different.

Senator FORD. You would start negotiating with airlines on your commission basis?

Mr. DAVIDOFF. We do, on an individual basis.

Senator FORD. So, if, just like Mr. Conway said, you are a special agent and you go up a certain height, then you get more commission than the normal agent; is that correct?

Mr. DAVIDOFF. This is true in any industry. You mentioned J.C. Penney yourself.

Senator FORD. Absolutely. They set a goal for it—it is a little bit easier to punch a button than it is to try on a pair of shoes.

Mr. DAVIDOFF. Maybe, maybe not. Travel agents have to be trained to use CRS systems. In today's complex travel marketplace there is no comparison between the experience and sophistication required of a travel agent and that of a shoe salesman.

Senator FORD. If CRS owners are prevented or at least delayed from raising their booking fees when necessary by a time consuming arbitration process, do you not expect they will find another way to pass on their costs, such as increasing CRS subscriber charges?

Mr. DAVIDOFF. We are concerned about that possibility, but the legislation does not delay the effectiveness of a booking fee increase while the arbitration proceeds.

Senator FORD. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Mr. Davidoff, how many, roughly, people are in the business of accepting or booking flights on airliners in your business, tens of thousands?

Mr. DAVIDOFF. You mean travel agencies or travelers?

Senator MCCAIN. Travel agents?

Mr. DAVIDOFF. There are currently approximately 32,000 travel agency locations in the United States.

Senator MCCAIN. 32,000 and how many airlines are there, major airlines; about 9?

Mr. DAVIDOFF. It depends how you count. There are six or seven that are operating under full solvency.

Senator MCCAIN. In other words, your business with 32,000 travel agents is highly competitive would you say?

Mr. DAVIDOFF. That is an understatement; yes, sir.

Senator MCCAIN. Thank you, Mr. Davidoff.

Mr. Conway, in Mr. Crandall's discussions that I have had with him and in his statement he will say that American Airlines invested in and bought Sabre, spent hundreds of millions of dollars, and lost money during its first year of operation and basically what this legislation would do would deprive American Airlines of the fruits of their labor in the free enterprise system. What is your response to that?

Mr. CONWAY. I do not agree with Mr. Crandall's statement, nor do I agree with the premise that just because one makes an investment of some amount and then incurs losses of yet a different amount, that that gives them unilateral right to take advantage of the marketplace and gain a noncompetitive edge that serves to put others at a competitive disadvantage that perhaps goes across the line as to what the laws of the land permit.

Senator MCCAIN. In other words, even if you have an enterprise, if that enterprise is predatory or leads to unfair business practices, there still should be some restraint on it?

Mr. CONWAY. Yes, I quite agree, Senator. For example, if it were determined that someone in any industry were in fact conducting themselves in a predatory fashion, I do not think it would be a sustainable defense that that is OK because I put a lot of money into this system and I lost a few dollars in the first couple of years.

Senator MCCAIN. And this legislation does not require divestiture of the system. It only requires elimination of certain biases which have been documented by most objective observers of the airline industry.

Mr. Crandall will also say in his statement that American has offered to sell America West an ownership interest in Sabre at fair market value but it has declined. Would you respond to that statement?

Mr. CONWAY. The first part of the statement is an accurate one. Yes, we were made an offer to participate by purchasing an equity piece of their CRS system. The part I would disagree with was fair market value. I think that is in the eyes of the beholder. When we analyzed the price that was being offered to us, it clearly could not be justified and to make matters worse, the amount of influence we would have had as an owner or part owner in that system was extremely negligible.

In summary, what was offered to us was a nonstarter in our view.

Senator MCCAIN. It is not also true that there was a proposal by American, and I believe Delta, to have a different kind of approach to this problem and the Department of Justice reviewed this proposal and found that it was sadly lacking in many respects?

Mr. CONWAY. That is my understanding, Senator.

Senator MCCAIN. There was a Department of Justice assessment of their proposal. I believe it was in 1989.

Mr. Davidoff, how hard is it for an average travel agent, one of these 32,000 travel agents, to get out of a contract? Suppose they said, "Look, I am tired of Sabre, I want to go to Worldspan." How hard is it?

Mr. DAVIDOFF. It is difficult today because there is an uncertainty on how much it would cost the agent. There are included the current contracts what are called liquidated damages whereby the agent agrees when signing the contract that if he were to leave the contract there would be a determination of the total losses to the vendor for a wide variety of things and it makes it very unspecific.

We are currently bound by what amounts to 5-year contracts and for example, a lot of agents in the Cleveland area had 5-year contracts with Covia for Apollo, and they had those contracts because at the time they entered into those contracts United was a very major servicing carrier in Cleveland. United cut way back in the marketplace in Cleveland.

Continental became the major player in the Cleveland market, and it was virtually impossible for these agents who wanted to switch to System One because Continental was now the major player and the most benefit would be gained from working with them. It was virtually impossible for them to get out of their contracts easily. Not that we say a contract should just be ripped up. There should be a specific amount stated and specific conditions stated as to how the parties can get out of the contract in a reasonable manner, including costs of course.

Senator MCCAIN. Thank you, Mr. Davidoff.

Mr. Kotar, there has been some question about the initiation of the low airfare war that frankly has contributed enormously to the attendance at this hearing. There are allegations by some that Northwest Airlines was the culprit here or let me put it in a kinder tone, was responsible for what many view as a multibillion dollar operating loss by all the airlines in America.

Yet, at the same time, as we have stated repeatedly, there is a great benefit to the airline passengers who are able to take advantage of this. But we are all concerned about the long-term impact, obviously. Can you define Northwest's role in this latest round?

Mr. KOTAR. I need to do that by explaining Northwest's perspective on American new fare filing earlier in the year. Mr. Crandall at American basically restructured the pricing of the airline industry into a four-tier level and to cut business fares by up to 40 to 50 percent.

Northwest in our most recent Grownups Fly Free promotion was an attempt to segment approximately 30 percent of the leisure travel which is about 50 percent of the business. We believed that this promotion, for a limited time period, would take advantage of a unique opportunity for cheaper fares. This was not targeted by the original American initiation of its new fare structure, and we felt that we would generate approximately $45 million in incremental revenue and have profitability of about $20 million.

We believed that all of our competitors would at a minimum match because it made sense because it was not focusing on the piece of the business that American's fare structure focused on. In fact, what American did was to come right down on our new fare promotion and across the board, initiated a 50 percent for every-

body. So, we went from what we believed would have been an incremental generation of $20 million for the summer in profitability to a $40 million loss across the board.

I have been in this business for 25 years: if that is not a predatory pricing action, I do not know what it.

Senator MCCAIN. So, in your view, Mr. Kotar, a case could be made that there was a case of predatory pricing in the action on the part of American.

Mr. KOTAR. I guess the way we would view it; and I got this from Mr. Davidoff, is that Northwest pulled out the squirt gun and American responded with a water cannon. From our perspective, the way we interpreted American's response, was that you are going to bleed quickly, you are going to bleed fast and die or you are going to bleed slowly and die and we are going to lead, we are going to force you to follow a pricing structure that we are going to dictate.

Senator MCCAIN. Mr. Davidoff, I am particularly grateful for the support that you represent of 32,000 Americans. Most of them are small business people in a free enterprise system that recognize that inequity has to be somehow addressed here so that we can provide not only the services to the people that are in your organization, but to literally tens of millions of people that they provide a service to. So, we are very grateful for the support of your organization.

Do you want to say anything?

Mr. DAVIDOFF. Yes, thank you, Senator. We are in the middle, but we are the closest to the travelers and it is the travelers of America who will be the biggest losers if we end up in a situation where there are only three or four carriers operating.

The air transportation system in the United States requires a multiairline competitive system, not just a three- or four-airline oligopoly. Our travelers believe this and we believe it. Our 32,000 locations represent close to quarter of a million people whose very livelihoods depend on this.

If we have another week like we had last week, where we were doing literally six times the volume of transactions as normal for something less than one-half the income, using overtime and driving our people almost to the breaking point, the whole system is going to come crashing down and that would be a total disaster.

Senator MCCAIN. Thank you very much. Thank you, Mr. Chairman.

Senator FORD. Let ask one question, Mr. Kotar, you made a very positive statement of predatory pricing by American. Are you going to court?

Mr. KOTAR. I beg your pardon?

Senator FORD. Are you going to court?

Mr. KOTAR. I can say this much, I am obviously not in our legal department, but given what has transpired yesterday between Continental and the fact that American has even gone to say what they did was not predatory, we are obviously going to look at it very carefully. It is under consideration right now.

Senator FORD. You said also in your statement that you waited until the last second almost on Tuesday night to insert into your system your family travel plan; is that correct?

Mr. KOTAR. Yes.

Senator FORD. What is different from that and what some of the other people do?

Mr. KOTAR. Nothing, except the fact that we——

Senator FORD. Nothing is all I wanted.

Mr. KOTAR. But the point was, Senator, the fact that every carrier tries to get a fare initiative out there so they can get a competitive advantage. The point I made specifically was that because United can enter their fares directly in the system, circumventing the industry methodology to accomplish it, they were able to match us the same day and the rest of the industry had to wait until a day later. It is because of this CRS hosting that United has that competitive advantage.

Senator FORD. What is difficult for me is that you own one-third of a system, CRS System, one-third of it.

Mr. KOTAR. Yes.

Senator FORD. That is your testimony and that you waited until the *n*th degree of time to insert your new rates into the system. And I guess that, since you own that, it went out very quickly; right?

Mr. KOTAR. No, sir, I did not want to get into the technology piece of this, but the industry——

Senator FORD. Do not get technical with me, I do not understanding technology very well either.

Mr. KOTAR. The point is, the industry has a company, Air Tariff Publishing Co., which is the vehicle by which all the airlines file their fares. They collect them and disseminate them back out to the airlines in the CRS's. Our intent was to get the ATP code into the CRS's and all the airline systems that they have. It had nothing to do with the fact that Northwest is a part owner in Worldspan.

It is pure and simple that United is opposed to using ATP code, the Airline Tariff Publishing Co., for getting their fares into their system, their fares went directly into United's Apollo system. That is something the other airlines do not have the right to do in the United system today.

Senator FORD. And United has the right to do that and that is——

Mr. KOTAR. That is consistent with the DOT rules, as a host you are allowed to have certain rights.

Senator FORD. So, that is Covia that they are in?

Mr. KOTAR. Covia.

Senator FORD. Covia, OK, I was close. Now I understand that their percentage of Covia is going to be reduced by the end of the year and they will pick up five to seven more airlines, is that correct, most of them international?

Mr. KOTAR. I believe that they are the seven carriers that are there today, they are just restructuring how the business will be done.

Senator FORD. I think that they will add some international carriers, according to the information I have.

Mr. KOTAR. I believe the same ones that are there, sir.

Senator FORD. OK, we will see if what they told me was correct or what you have the record, so I want to be sure and find out.

This is interesting to me and I have a hard time understanding the problem if you want to send out this new rate that is going to bring you so much money and somebody else challenges that. Everybody in this room knew that Eastern Airline was just there for a few days and they reduced their fares to get a little cash flow to keep going. Other airlines had to meet that.

Mr. KOTAR. That is correct.

Senator FORD. And it absolutely took some of them down financially. Other carriers knew that Eastern was going down in just a matter of days, but the fare was so low. I did not hear the ranting and raving then of being put out of business and predatory pricing and that sort of thing. Now I hear that you are ganging up on one airline.

Mr. KOTAR. Sir, we have a different situation here.

Senator FORD. I understand the different situation, but the procedure in my opinion was the same.

Mr. KOTAR. Well, it is not, it is not the same at all. The fact is that historically, as airlines have filed fares, other airlines have the choice to either match those fares or not match them.

Senator FORD. That is correct.

Mr. KOTAR. We have a particular case in point here where American Airlines set an entirely new pricing structure which the other airlines had absolutely no choice but to match, and then when Northwest tried to pinpoint a summer fair promotion which historically this industry has done, for a specific part of the traveling public that the previous fare promotion they put in place did not address, American came down like the elephant on the flea and said, "You are all either going to play in my game or you are out of here, pal."

Senator FORD. Well, I apologize and John is going to get back in this too, but you just said that other airlines did not have to match Eastern and why do you have to match American?

Mr. KOTAR. Because in certain market segments where Eastern may or may not file fares, you can either choose to match or not match, it depends on what kind of——

Senator FORD. You can choose to match or not match in any market; can you not?

Mr. KOTAR. Not with what American did in restructuring the pricing structure.

Senator FORD. Can you not do that, can you not make that decision to match or not match fares?

Mr. KOTAR. You can always do that, sir.

Senator FORD. That is all I wanted to——

Mr. KOTAR. But when someone sets a restructuring of how the industry is going to work, this is not like you are going into Penneys to buy a pair of underwear and you go to Sears and the same underwear 50 cents less and whether you match it or not you can make that decision.

This is somebody coming out and saying this is how this industry is going to work and if you do not want to play, you are out of it.

Senator FORD. I think you are downgrading yourself on the basis that one airline is dominant and it is telling you what to do and what not to do, when to go broke or when to make money and that sort of thing. I do not think you can blame American for that.

Mr. KOTAR. When you have one airline that runs 40 percent of the electronic distribution business and one airline that is as pervasive as American is, they can set that policy, sir, and I would suggest to you they do.

Senator MCCAIN. Mr. Conway, did you want to comment on that?

Mr. CONWAY. I think in all due respect, Mr. Chairman, the fare initiatives by Eastern Airlines bear absolutely no comparison in the order of magnitude of the one that we just had led by American Airlines.

Senator FORD. Well, Mr. Conway, would you also say, would you agree with me a little bit though that those low fares did jeopardize the financial income of some airlines that had to compete with them on their extremely low fares?

Mr. CONWAY. Not necessarily. I am not so persuaded, Senator. I think you would have a great deal of difficulty tracing the actual demise or major change in financial stability of any carrier today, traced to any Eastern Airline initiative.

I think the reason why you had such rapid matching of a unprecedented fare restructuring is that to not have matched would have been instant suicide and Eastern was not matched across the board and where they were, they were matched on a capacity-control basis.

What we have here is virtually all excursion fares in the peak summer period being slashed absolutely one-half at levels far below the cost of providing the product. Eastern never did anything like that.

Senator MCCAIN. Let me just make one aside here also, the day after Eastern stopped flying from Chicago to Miami, United Airlines raised its lowest fare on the route from $198 to $379. That happened on Eastern routes all over the country.

So, the fact is that when we lose competition, fares go up. There is a clear record of that and if you engage in predatory pricing, it drives airlines out of business as it reduces competition. We will see repeats of what happened on the routes that were competitive and when Eastern Airlines went out business and there was no longer any competitor. Is that true, Mr. Davidoff, in your experience?

Mr. DAVIDOFF. Very much so. The airlines act like lemmings going to the sea. They follow the lowest leader. They follow the weakest marketer. They have given up on profitability. They do not know what it means. They are far more interested in market share and keeping their market share than following what is the basic rule of business. You set prices to cover costs. If you cannot set prices to cover costs, you cannot run a business.

Senator MCCAIN. Since we are using a lot of comparisons today, I also am reminded of the contests that they have in Las Vegas where everybody starts out and who ends up with the most money wins and everybody else is out of the game. It would be very helpful of course if you started out with the most money rather than an equal share.

So, I thank you, Mr. Chairman. I know we will be engaged in this for a long time. It is very stimulating.

Senator FORD. And I am looking for lemmings now. I will get to that sea, but I do not think that people that are here at this table

were competing in Atlanta and Miami when the Eastern fares were down to $50 and $60 a fare. You did not make much either, Mr. Davidoff——

Mr. DAVIDOFF. That is for sure.

Senator FORD. Thank you, gentlemen, we appreciate it, and I am sure we will be in touch with you before very long.

We will hear from Mr. Robert L. Crandall, Chief Executive Officer, American Airlines. Mr. Crandall.

STATEMENT OF ROBERT L. CRANDALL, CHIEF EXECUTIVE OFFICER, AMERICAN AIRLINES

Mr. CRANDALL. Thank you, Senator.

Senator FORD. I know you will defend yourself well.

Mr. CRANDALL. I shall do my best. I feel like saying, the Chief Lemming reporting for duty, sir. [Laughter.]

Senator FORD. You may proceed in any manner in which you want to and if you have a statement we will include it in the record. If you want to highlight it or answer some of the criticism——

Mr. CRANDALL. Thank you, Senator. I have a brief statement. I am very pleased to have an opportunity to give you my views regarding S. 2312 and to comment as well on the general subject of airline competition.

Now this legislation is ostensibly intended to increase airline competition, but most of what has been said today and particularly by the last panel has been about too much competition.

I really do not think there can be any serious debate about whether the airline industry is or is not enormously competitive. It clearly is. In virtually every U.S. origin and destination market, consumers have more options today than they did a dozen years ago and in the last 2 years the U.S. commercial aviation industry has lost nearly $6 billion something which could hardly have happened in a noncompetitive industry.

Thus, in my opinion at least this hearing is not about whether the airline business is competitive, but about whether Congress should impose penalties on successful competitors for the benefit of the less successful, some of whom are seeking to blame the sponsors of computer reservation systems for their competitive failing.

The loudest complainers are America West and Northwest. America West's employee owners recently had a study done to determine what is wrong with their company. In this thick document, there is only passing mention of CRS and very little about airlines other than America West itself, but there is a great deal about a management which has lost its focus on America West's original plan to provide low-cost point-to-point service, which has wasted money buying 747's and flying to Hawaii and flying to Japan and doing all manner of other things unrelated to running a competitive airline.

This report's conclusions are succinct, America West's management has failed. Northwest, another loud complainer, is a privately held company. It got that way because its owners are 1980 style wheeler dealers who loaded up Northwest's balance sheet with debt.

Now Messrs. Checchi and Wilson bought Northwest because it holds one of the most valuable aviation franchises in the world, very broad rights to fly to Japan from the United States and to carry local traffic beyond Japan to many points in Asia. Those rights were granted to Northwest by the U.S. Government in 1946 absolutely free of charge.

American cannot compete with Northwest in Asia because we have no hope of ever being granted equivalent rights. Conversely, the CRS industry, about which Northwest complained so loudly, is open to all who choose to compete. In fact, as part owner of one of the largest CRS systems, Northwest is a CRS competitor.

And while there can be no doubt that Northwest's routes to Asia are far more anticompetitive than American's CRS position, Northwest nevertheless complains endlessly.

Senators, the business of commercial aviation is quite different than any other business. First, the airlines must make enormous capital investments to buy the aircraft and other equipment they use. Thus, airlines have very high fixed costs and an enormous financial incentive to sell any empty seat for any price that exceeds variable costs.

So long as there is any excess capacity at all, airlines will tend to compete prices downward toward variable costs and since tickets sold for variable costs are unprofitable, an overpopulated airline system is very likely to be perpetually unprofitable.

Second, airline competition is exacerbated by the unfortunate reality that consumers regard one airline seat as the same as an other airline seat. Moreover, they have perfect information, thanks to CRS's about every airlines' prices and product availability. Because of those truths, every airline must match the prices of every other or lose the business.

Third, the industry has very little ability to reduce its costs. Since the airline industry is heavily unionized, labor costs cannot be changed without the consent of unions, quite understandably, they are unwilling to consent and since no airline can tolerate a strike, labor costs are not truly variable.

Fuel costs cannot be changed, commission costs cannot be modified because travel agents distribute 80 percent plus of our product and any airline that does not have a positive relationship with travel agents faces the loss of huge amounts of business.

Nor can an airline improve its results by reducing its service, since frequency of service is one of the primary determinants of consumer choice, an airline which reduces its schedules, so long as its competitors do not, will find that its revenues go down faster than its costs.

Now for all of those reasons, it is very, very difficult for U.S. airlines to operate profitability, that is why there are so few other countries in the world which have competitive airline systems. Since most countries are more concerned about the health of the airlines than the welfare of their consumers, most choose to limit real airline competition.

Now does that mean I advocate regulation in the United State? It definitely does not. The United States is the largest aviation market in the world and I believe that market can and will support multiple carriers. On the other hand it is naive to believe that be-

cause we have hundreds of different department stores we can have hundreds of different airlines.

If we want a competitive airline system, we must allow the market to finish the painful process of eliminating surplus capacity. Now I am often asked how many airlines will survive? I do not know the answer, but I am certain there will always be more than enough airlines to provide intense competition.

I also feel strongly that a deregulated system is far better for every aviation constituency, employees, communities, investors, and consumer alike.

Senators, the airline industry is intensely, vigorously, bitterly, savagely competitive. Still, there are some things that you can do to be certain that every one who wishes to compete has an opportunity to do so and to ameliorate the harmful effects of our transition to a competitive environment.

First, you should insist that the Aviation Trust Fund be spent promptly, to increase air traffic control capabilities and build more runways and airports.

Second, you should compel the FAA to eliminate the slot constraints which limit competition at JFK, Washington-National, LaGuardia and O'Hare.

Third, you should require that real estate at every airport at the United States be leased on a month-to-month basis and that every lease contain use it or lose it provisions.

Fourth, you should change the bankruptcy laws so that no carrier can use them to drive the industry's prices to noncompensatory levels.

Fifth, you should forbid waivers of pension fund contributions, thus guaranteeing workers that their employers will not cheat them out of promised benefits.

Sixth, you should loosen the restrictions on foreign ownership of U.S. airlines, provided that any country whose citizens may buy U.S. airlines should be required to offer reciprocal rights to U.S. citizens.

Seventh, you should change the tax laws to that airlines that lose money are not required to pay income taxes, and finally, you should direct the State transportation departments to be more aggressive, a lot more aggressive about securing international opportunities for U.S. airlines.

Senators, whatever you do, you should not seek to micromanage the airline business. None of the provisions of the bill under consideration make economic sense. None of them will have any effect except to diminish rather than enhance competition.

Moreover, before you do anything to damage the strongest U.S. airlines you ought to think carefully about the importance of the travel and tourism industry which is the largest employer in the United States. To give you some idea of its impact, the extraordinary airfare sale which Northwest launched with its Adults Fly Free initiative and which ended last Friday is going to create at least 70,000 new jobs in America and stimulate our economy by more than $2.5 billion this summer.

It was a foolish sale which will cost the airline industry dearly, but it was a natural result of competition and its impact on the Nation's economy will be very positive.

This summer aside, it is vitally important that the United States have a safe, efficient, and competitive domestic transportation system, and that its airlines be effective competitors on the world stage. The only way to assure that result is to let the market do its work of shaping the most competitive and efficient system possible.

Thank you for your attention, and I will be glad to try to answer any questions you may have.

[The prepared statement of Mr. Crandall follows:]

PREPARED STATEMENT OF ROBERT L. CRANDALL

We are here today to discuss competition in the airline industry, and whether the government should act to damage successful competitors for the benefit of the less successful.

While this is an important subject, it is far less significant than other issues with which the Congress—and the people—are concerned. Our national economy is finally emerging, slowly, from a long and very painful recession. While the recovery is welcome, I know of no one who thinks our economic problems are solved. Our national agenda includes an out-of-control federal budget, an inoperative health-care-delivery system, schools which do not teach our children effectively, a dysfunctional judicial system, polarized race relations—and a disheartening public pessimism about our economic future.

The airline industry has not escaped the economic adversity of recent months and is afflicted by a unique set of problems related to its underlying economics. Before discussing those problems, and suggesting some solutions, let me spend just a moment on an often-overlooked piece of good news.

By many standards, the U.S. airline industry is a great success. We provide a very high quality product and sell it to consumers for far less than the prices charged aviation consumers elsewhere in the world. We provide good jobs and above-average wages and benefits for more than 500,000 employees, each of whom supports, on average, about 1.4 dependents. U.S. airlines are a major force in international aviation and, as shown by the defensive posture of many foreign governments, can be even more successful in the future with appropriate support from the U.S. Government.

The CRS industry—a badly misunderstood activity of some airlines—is also a great U.S. success story. The CRS industry was created from whole cloth by American, United and a handful of others 15 odd years ago. Today, it employs more than 5,000 people in the U.S. and many more around the world, and provides the travel and tourism industry—and U.S. consumers—with extraordinarily efficient distribution services. While CRSs are no longer offered solely by U.S. vendors, U.S. companies still offer the world's most efficient systems.

Despite these accomplishments, the U.S. airline industry is in profound financial distress. and that is why I am testifying before this Committee. There are those who say—indeed, the title of the Bill before you suggests—that the industry's problems stem from the success of some competitors, who must now be deliberately harmed in the name of competition. Not surprisingly, those saying this the loudest are the industry's least successful participants, and their supporters.

Such a view is both profoundly naive and contrary to every tenet of the free enterprise system; should such action be taken, a bad situation will be made worse. The airlines are the principal intercity transportation system in the United States—and the core component of the enormous Travel and Tourism business.

At nearly $700 billion, Travel and Tourism is the nation's largest industry—by far. It meets an annual payroll of $200 billion, pays nearly 5 percent of the country's taxes, serves as justification for nearly 7 percent of all capital investment and accounts for more than 6 percent of our GNP. Travel and Tourism employs 9 million people, thus providing nearly 8 percent of the nation's jobs—more than three times the jobs in agriculture, electronics or textiles and more than 10 times the number employed in either autos or steel. Moreover, in recent years, travel and tourism has been growing faster than the economy overall.

Because airlines are such an integral part of the travel and tourism industry, those who propose to deliberately harm the industry's most successful competitors for the benefit of less successful ones should consider the consequences of their actions carefully. The adverse consequences of such actions will, in my view, be far more profound than any of you can imagine.

Is the airline industry competitive? Senators, this is, if not the most competitive industry in the world, certainly one of the most competitive. That is why airlines lost, collectively, nearly $6 billion in 1990 and 1991; American's loss in this period was $280 million. It is not just competitive: As the numbers suggest, it is savagely competitive.

Can it be made more competitive still? Probably, but there can be no doubt that it is already far more competitive than most industries.

Before discussing some possible solutions for the industry's problems, I'd like to talk about the unique economics of our business and comment briefly about how those economics, and the events of the last 14 years, have brought our industry to where it is today.

THE ECONOMICS OF COMMERCIAL AVIATION

Senators, the business of commercial aviation is quite different than any other business—and its unique economics have a great deal to do with how individual airlines, and the industry as a whole, behave.

First, airlines must make enormous capital investments to buy the aircraft and other equipment they use. Since the industry's huge investments create very large fixed costs, there is enormous financial incentive for every airline to sell any seat not claimed by full-fare passengers for any price which exceeds variable costs and thus earn a contribution to its heavy fixed charges. So long as there is any excess capacity at all—and there is, by definition, excess capacity in any scheduled airline system—airlines will tend to compete prices downward toward variable costs. Tickets sold for variable costs, by definition, are unprofitable—hence, an overpopulated airline system, in which the pressure for revenue growth is so strong as to cause many carriers to regularly offer many seats at prices lower than the fully allocated costs of most competitors, is likely to be perpetually unprofitable.

Second, airline price competition is exacerbated by the fact that consumers regard one airline's seats as perfectly substitutable for any other airline's seats and have perfect information about every airline's prices and product availability. Because of these truths, every airline must match the prices offered by any other; thus, any airline which chooses to reduce its prices will drive its competitors' prices down to that level.

Third, the industry has very little ability to change its costs. As I have already noted, airlines have extremely large fixed costs. The largest items of variable costs are likewise not easily changeable. As you all know, the airline industry is heavily unionized; thus, labor costs cannot be changed without the consent of unions, which are unwilling to agree to lower wages and benefits. Since no airline can tolerate a strike—our own company would run out of cash in about six weeks—labor costs are not truly variable. Fuel costs cannot be changed. Commission costs cannot be modified because travel agents distribute 80-plus percent of our product and every airline must either have a positive relationship with travel agents or face the loss of tremendous amounts of business.

Nor can an airline improve its results by reducing the number of flights it operates. Since frequency of service is one of the primary determinants of consumer choice, an airline which reduces the frequency of its service—so long as its competitors do not—will find that its revenues go down faster than its costs.

For all these reasons, it is very, very difficult—for some time, it has proven impossible—to operate profitably in an overpopulated competitive system. That is why there is no other country in the world, to my knowledge, which has a genuinely competitive airline system. Since most countries are more concerned about the health of their airlines than the welfare of their consumers, most choose to regulate airline competition.

Does this mean I advocate regulation in the United States? It emphatically does not! The U.S. is the largest aviation market in the world and I believe that the market can and will support multiple carriers.

On the other hand, it is naive to believe that because we have hundreds of different department stores, we can have hundreds of different airlines. If we want a competitive system, we must allow the market to finish the painful process of eliminating whatever number of carriers are surplus to the market's needs.

THE U.S. COMMERCIAL AVIATION INDUSTRY SINCE DEREGULATION

In the years following deregulation, the U.S. commercial aviation industry has been a tumultuous and very high-risk environment. During the early 1980s, a host of new, upstart carriers, many weakly capitalized and badly managed, entered the business. Very few of those running the new entrants understood the essential economics of our industry.

There have also been many mergers and combinations, as well as a host of asset and route sales.

During this period of rapid change, the established carriers chose various strategies. At American, we launched two broad initiatives, each of which has profoundly shaped what our Company is today.

First, we set out to lower our costs by growing rapidly. To do so, we made huge capital investments in new, more efficient aircraft, spending a total of almost $7 billion between 1983 and 1988. We also introduced what was, in the early '80s, a very innovative compensation structure. That structure offered our newly hired people market rates, that is, the same rates being paid by new-entrant carriers. The more we grew—and the more new, lower cost employees we hired—the lower our costs. And grow we did: Between 983 and 1988, we almost doubled the size of our jet fleet, which grew from 244 to 468 aircraft, and we increased our workforce by 81 percent, hiring 35,000 new employees.

Second, knowing that we would always be a high-cost airline, despite our growth, we set out to aggressively develop our data-processing and communication capabilities. Among the things we did was develop and market a computerized reservation system for use by travel agents. We undertook the latter project with great trepidation, deciding to proceed only after other airlines declined to participate in a joint-venture development we sought to organize. In the years before SABRE became profitable, we invested more than $300 million and suffered losses of more than $100 million, all in the hope that our CRS would some day be a successful venture.

During this time, each of our competitors developed its own strategy. Some—United and TWA and, later, Eastern—developed CRS systems to compete with ours. Some airlines acquired their competitors, as Northwest did when it bought Republic, and as TWA did when it bought Ozark. Continental, as you all know, was part of the Texas Air group, which embarked on a feeding frenzy of acquisitions.

Every airline developed multiple hubs as a way to maximize revenue and optimize operating efficiencies. Most airlines bought some aircraft, although many different combinations of aircraft types were chosen; TWA chose to pursue an old-aircraft strategy, believing that financial commitments for new aircraft were foolish.

Some of our competitors invested in other industries—Pan Am and United in hotels, United in rental cars. Some airlines chose to pay dividends to their shareholders. American sold its holdings in other industries and denied dividends to its stockholders in order to buy airplanes and computers.

Northwest and TWA were taken over in financial transactions that heaped debt on their balance sheets.

Every airline is what it is today as a result of the choices it made in the 1980s. Some chose well, some poorly. But the right to choose, and to win or lose, is at the heart of the free enterprise system.

To a considerable extent, the industry's problems are the consequence of the regulation to which it was subjected for 40 years. The market is vigorously correcting the errors forgiven by a regulatory system which prevented failure. The correction is so severe that for the last several years, only one carrier, Southwest, has been consistently profitable. The three so-called megacarriers—Delta, United and American—have lost a total of $1.1 billion in the last two years.

THE GOVERNMENT'S ROLE IN THE AIRLINE INDUSTRY

Given the turmoil in the airline industry, and the industry's significance to the nation's economy, some have called for governmental intervention. While it is easy to understand the concern, it is impossible, given the stupendous losses we are all suffering, to comprehend how anyone can think that the industry is not competitive.

While it is beyond the power of this or any government to create an idealistic model of competition to which free-market companies will conform, or to repeal the laws of economics which govern the behavior and the fate of our industry's participants, there is much that government do: (a) to assure that all aspirants have an opportunity to compete, and (b) to ameliorate the adverse economic impacts of external but controllable factors.

ACTIONS THE GOVERNMENT CAN TAKE TO ASSURE PARTICIPATION BY ALL ASPIRANTS

1. First and foremost, the government should insist that the Aviation Trust Fund be spent—and spent promptly—to increase air traffic control capability and build more runways and airports, thus encouraging full-blooded competition by all who wish to compete.

Only the government can create capacity, and it has done far less than it should have to do so. Instead of making a determined effort to increase capacity, the government has allowed the balance in the Aviation Trust Fund to increase—from $6

billion a few years to $16 billion today. That means that airline passengers have paid $16 billion more in ticket taxes than has been spent on the safer skies, reduced delays, better facilities and increased capacity that were promised when the tax was imposed. The reality is that the Trust Fund is hostage to the apparently hopeless federal budget deficit—and a cruel hoax on aviation consumers!

I recently reviewed some of the legislative history of S. 1600, in the 100th Congress, which was Chairman Ford's effort to impose major reform on the Federal Aviation Administration (FAA). Mr. Chairman, if you reread the statements you made then, you will be proud of your foresight, and dismayed at how little progress has been made toward solving the problems you identified.

2. You should compel the FAA to eliminate the slot system now in place at JFK, Washington National, LaGuardia and O'Hare. Slots were a "temporary" fix for a supposedly "temporary" problem back in 1969. In the intervening years, the FAA has spent billions of dollars to improve the ATC system, but has not created a single additional slot! It is clear that slot controls are the victim of bureaucratic hardheadedness and, absent compulsion, will never be eliminated.

Three years ago, Senators Ford and McCain suggested abolishing them. It was a good idea then and it is a good idea today. Every single justification for the so-called high-density rule has long since been eliminated. Yet, slots still exist, a monument to regulatory inertia.

Senators, I urge you to direct the FAA to eliminate the high-density rule, and the slots which limit competition, without further delay. Your reward will be an immediate increase in capacity and thus, in competition.

3. I think it would be entirely appropriate for you to require that real estate at every airport in the United States be leased on a month-to-month basis and that every square foot of space and every gate be subject to use-it-or-lose-it constraints, thus preventing incumbents from warehousing facilities needed by competitors.

4. I see no reason why you should not loosen the restrictions on foreign ownership of U.S. airlines. Of course, we should provide that any country whose citizens are empowered to buy U.S. airlines should be required to offer reciprocal rights to U.S. citizens.

5. Congress should direct the U.S. Government—the Department of Transportation and Department of State—to be far more aggressive in aviation negotiations with other countries. Today, the U.S.—which is the largest aviation market in the world, and hence a market to which foreign carriers desperately desire access—declines to use its powerful leverage to assure equal opportunities for U.S. carriers.

Time and again, when foreign governments refuse to honor the obligations contained in bilateral aviation agreements, the U.S. forgives their noncompliance and gives foreign-flag carriers incremental opportunities inconsistent with their bilateral entitlements and disproportionate to opportunities granted to U.S. airlines. In recent months, negotiations with the French, the Spanish, the Italians and the British have been conducted with timidity and deference—and the results have been predictably adverse.

For example, Iberia now has the right to operate a hub in Miami, while U.S. carriers have very limited access to Spanish cities and no beyond rights at all. U.S. carriers are forbidden by the U.S. Government to operate flights authorized by the U.S.-French bilateral, despite the fact that the French have already renounced that agreement and announced that they will seek, when it is renegotiated, a large improvement in Air France's competitive position. In Italy, U.S. carriers have very few rights, despite the fact that Alitalia holds various unutilized routes. British Airways continues to have a huge assortment of U.S. route rights, many unutilized, while U.S. flag carriers' desires are unsatisfied.

U.S. carriers, despite multiple promises of resolution, are still unable to handle their own passengers in Zurich. U.S. CRS systems are unsalable in Spain because Spanish carriers, owned by Iberia, refuse to make their seats available for sale. Air France, which owns that country's domestic carriers, declines to direct them to make their seats available to U.S. CRS vendors. And around the world, U.S. flag carriers pay exorbitant rates for flight handling, tolerate inadequate terminal facilities and are otherwise discriminated against in a hundred important ways.

Senators, such circumstances are more than unacceptable; they are nonsensical—unless, of course, we do not want our carriers to be competitive in international markets.

ACTIONS THE U.S. GOVERNMENT CAN TAKE TO AMELIORATE THE ADVERSE FINANCIAL IMPLICATIONS OF INTENSE COMPETITION

1. U.S. bankruptcy laws, particularly Chapter 11, which permits ongoing, long-term operation by bankrupt companies, must be changed.

Since all airlines must price their seats at the lowest level set by any competitor, continuing operations by bankrupt carriers, whose costs are dramatically lower than those of carriers paying all their bills, have the effect of forcing full-cost carriers to lose money and of draining equity capital out of the airline industry. Given the economics of aviation, the industry will inevitably continue to lose large amounts of money so long as competitors are sheltered by statutes which encourage them to establish prices on the basis of partial costs.

No company would be found fit to become an air carrier if it were insolvent at the time it applied for certification. All of the safety and public-benefit considerations that make financial viability relevant at the time of certification are of continuing interest so long as a carrier holds a certificate. Moreover, U.S. law anticipates that to be the case, for it requires that the Department of Transportation make continuing judgments as to every carrier's fitness. It is time for the Congress to require the DOT to withdraw certification from carriers unable to meet their financial obligations.

A recent article in TIME Magazine explains the bankruptcy problem quite well. I have attached that article to my testimony and hope each of you will take time to read it. The reality of the airline business is that no bankrupt carrier has managed a successful reorganization. Braniff is operating under bankruptcy-court protection for the third time, Continental for the second. Under the "guidance" of the bankruptcy court, Eastern was allowed to lose hundreds of millions while in bankruptcy, until virtually nothing remained for its creditors. In the end, Eastern's employees lost their jobs and their pensions, and Eastern's ongoing operation imposed huge losses on other carriers as well.

2. The government should modify the Employee Retirement Income Security Act of 1974 (ERISA) to forbid the granting of pension-contribution waivers.

Bankrupt companies should not be allowed to suspend contributions to their pension funds, thereby increasing the liabilities of the Pension Benefit Guarantee Corporation (PBGC). Among other things, such actions cause the PBGC to increase the premiums it charges the sponsors of healthy pension plans. During the past five years, American's annual PBGC premiums have gone from $522,000 to $5,100,000.

In addition to imposing on ourselves and other companies the burden of paying the pension costs of our competitors, the practice of imposing ever-higher premiums on fully funded pension plans discourages companies from becoming or remaining pension-plan sponsors. It is clearly bad public policy for the government to encourage companies to cancel pension plans, thus increasing the economic uncertainties of America's ever-growing corps of senior citizens.

3. As appropriate, tax laws should be reformed.

When Congress revised the tax code in 1986, it sought to correct code deficiencies which allowed companies earning large profits to avoid paying taxes. Unhappily, this sensible-sounding reform—and the alternative minimum tax (AMT) it spawned—have had very adverse consequences for the airline industry.

In the last two years, AMR lost $280 million. Nonetheless, AMT rules required us to pay $226 million in federal income taxes. Clearly, Congress did not intend to force companies which lose money to pay taxes—and the law should be changed to reflect that fact.

4. Finally, The Congress should direct the agencies of government which regulate the airline industry to stop increasing the industry's regulatory load and to look for ways to reduce the heavy burden it already bears.

There are many examples of this excessive regulation. In March, in response to the President's call for a reduction of government regulation in his State of the Union Message, American submitted a list of more than 100 regulations which could—and should—be eliminated or modified. Yet the juggernaut of regulation rolls on.

For example, nothing has been done to reduce the excessive international security regulations which the Administration has imposed on U.S.—but not foreign—carriers flying to the U.S. These rules, about which we have protested for years, have driven up U.S. flag carriers' costs and aggravated our customers, while simultaneously sending a message that the U.S. Government thinks U.S. citizens are safer traveling on foreign carriers than on our own.

Another example is the FAA's recently mandated controlled access door requirements, which will cost the industry $700 million—roughly four times the FAA's original estimate.

The DOT's most recent security proposal would force the industry to do extensive criminal-background checks on nearly 600,000 airline and airport employees. These investigations will cost hundreds of millions of dollars and add substantially to the elapsed time required to hire an airline employee, but will add absolutely nothing to the real security of U.S. airline passengers.

CRS

The subject of regulation brings me to CRS regulation. The Bill under discussion, premised on your acceptance of statements by our competitors to the effect that CRS is both a barrier to entry and anti-competitive, proposes radical regulation for the purpose of depriving American and United of the benefits of CRS ownership.

The facts are that CRS is and has been a tremendous procompetitive force. By providing an electronic shelf on which new entrants can display their product to more than 100,000 travel agents, CRS facilitates market entry. Furthermore, by giving consumers perfect information about every airline's prices, CRSs create a brutally demanding competitive environment in which every carrier must match any lower price offered by any other airline. There is no other industry about which consumers have such perfect information. CRS systems give airlines no place to hide—we either have the best prices or we lose the business.

I do not want to belabor the issue of CRS today. We have testified many times, and filed innumerable studies, reports and white papers on the subject. Nonetheless, I do want to make the point that the only real problem that anyone has raised, and the principal fact about which our competitors complain, is that CRSs have succeeded, and by doing so, have enabled us to earn a return on our investment.

Is that bad? I do not think so, and I hope you don't, either. I also hope you will agree that a successful CRS investment is no less admirable than a successful investment in hotels or rental cars.

But unlike those who own hotels or rental cars, those of us who took the risk of investing in the CRS industry have had to respond to a never-ending parade of half-truths about CRS. When one is put to rest, another pops up, full grown.

Since 1976, American has invested hundreds of millions of dollars in SABRE. For the first six years, our CRS lost money hand over fist. No one told us then that it was bad public policy for an airline to own a CRS. We only launched SABRE after other airlines, including Northwest, refused to participate in an industry-wide joint venture which we sought to organize.

Because we have grown weary of this debate over the years, we tried in 1989 to do what we were unable to achieve in the mid-1970s—that is, to make SABRE an industry utility by proposing to make it part of a joint venture with what was then Delta's Datas II. We also offered non-CRS owners the right to buy shares in the utility. DOT had no real objection to the SABRE-Datas transaction; its two minor concerns were easily addressed. But the Department of Justice (DOJ), after heavy lobbying by various critics of our CRS ownership, rejected the transaction. It never did explain why, except to say it didn't want any more airline mergers. But of course that transaction was not an airline merger; it was a good-faith effort to divest ourselves of SABRE. Then, despite the fact that it wouldn't let Datas II and SABRE merge, DOJ turned around and let Delta merge Datas II with a CRS jointly owned by Northwest and TWA.

We tried hard to make the Datas deal work—not because we wanted out of the CRS industry, but to silence the critics once and for all. We tried especially hard to persuade America West, one of the most vocal critics, to invest. Yet despite complaining daily of the unfair competitive advantage afforded by CRS ownership, it declined. Yet that same carrier, despite its bankruptcy, recently invested in a Phoenix sports arena.

Earlier this Spring, American gave the Department of Transportation a detailed explanation of recent changes in CRS functionality, and explained why further regulation is simply not necessary. I will briefly summarize the points we made.

1. The legal and economic theories supporting CRS regulation have been invalidated. On October 29, 1991, the Ninth Circuit Court of Appeals affirmed a District Court decision that American and United had not violated the Sherman Act in the operation of their CRS systems (*Alaska Airlines, Inc.* v. *United Airlines, Inc.*, 948 F.2d 536 (9th Cir., 1991)). Specifically, the Court found that SABRE and Apollo were not essential facilities as defined by the antitrust laws, and held that the monopoly leveraging doctrine is not applicable. Two years earlier, a federal jury, after a three month trial, found that no violation of the antitrust laws by either American or United had occurred. A summary of the findings is attached. On April 6, 1992, the Supreme Court denied certiorari (112 S. Ct. 1603 (1992)).

American and United have won every court case challenging their contracts with travel agents, including the liquidated damages clauses in those contracts. Both the Second and the Fifth Circuit Courts of Appeal have upheld decisions on this issue. See, *American Airlines, Inc.* v. *Nationwide Trading Enterprises, Inc.*, (no. 91-1183) (slip op. 5th Cir., Oct. 2, 1991), and *United Airlines, Inc.* v. *Austin Travel Corp.*, 876 F.2d 737 (2d Cir. 1989)

The academic literature on CRS also rejects the charge of unfair competition. Two recent articles have been provided to the committee.

Travel Trust International, a consortium of travel agencies whose total sales exceed $6 billion annually, in a filing made with DOT in Docket No. 46494, on November 20, 1989, argues that there is no longer any reason for CRS rules at all. In its words, there is "ample evidence of healthy competition among CRS vendors." It argues that competition will be best enhanced by simply eliminating the current rules.

2. Technological advances continue to eliminate the few minor procedural differences which still differentiate how CRS owners and CRS participants use these systems. The few remaining programming defaults are meaningless; nevertheless, we are now eliminating them, and have committed to finish the process by April 1, 1993.

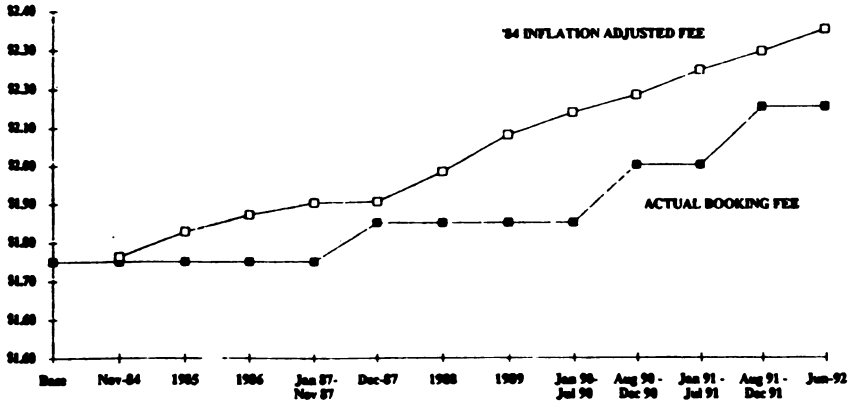
3. CRS ownership is open to all airlines. Contrary to the impression left by some critics, every major airline either has an ownership interest in a CRS or has decided it does not want to be an owner. American has offered to sell America West an ownership interest in SABRE, at fair market value, but it has declined. If CRS is the lucrative business it is claimed to be, why wouldn't America West jump at the chance to join us in our venture? Our offer to sell an interest in SABRE to any interested party remains open. Those that have had the opportunity to invest, but have chosen not to, are in no position to complain today.

4. Intrusive regulation will cripple the ability of U.S. CRS systems to compete abroad. In Canada, Europe and Asia, U.S. vendors are battling for CRS business which, if won, will be substantially helpful to the U.S. balance of trade. Our foreign competitors are significantly subsidized by their governments and enjoy the benefits of discriminatory practices by foreign-flag carriers that the U.S. Government has declined to stop. Adding more cost, and more regulatory constraints, will make it even more difficult for U.S. systems to win these competitive battles. Indeed, it will virtually assure our defeat.

5. Competition at the travel-agent level is more intense than ever. CRS vendors compete vigorously for travel agent CRS contracts, and the smaller CRS systems continue to gain market share. We are already losing ground; our competitors neither need nor deserve legislated advantages.

6. CRS booking fees have been declining steadily in real dollars and, by any measure, are a superb value. In 1991, America West paid SABRE a little less than $12 million in booking fees for approximately six million America West segment bookings, with an estimated revenue value of at least $350 million. These fees compensate us for our investment and pay for all the functions the system performs. We estimate that America West pays six times as much in travel-agent commissions as it does in booking fees. The chart below shows booking fees for the past eight years, adjusted for inflation.

FULL AVAILABILITY BOOKING FEES



Airline booking fees are far lower than those charged by companies offering similar services in other industries and in other parts of the world. U.S. airline CRS fees are lower than airline CRS charges in Europe, lower than the booking fees CRS systems charge rental car companies and hotels and vastly lower than fees charged by vendors of tickets for theater performances and sporting events.

Thus, by any measure, CRS airline booking fees are a great value. Since one of the premises of this legislation is that booking fees are excessive, this proof that they are declining and are the best value of their kind should make it clear that Congressional action is inappropriate.

CONCLUSION

Senators, the CRS debate is nothing but an intra-industry dispute, wrapped in the mantle of public policy to lend respectability to those who complain. Having failed in court to prove that there is anything illegal about CRS activities, and "having failed in the very competitive marketplace to which they pay verbal homage, our competitors now seek the antithesis of competition—regulation! This Bill should be not be called the "Airline Competition Act of 1992"; instead, it should be labeled the "Airline Re-regulation Act of 1992"—and it should not become law.

It is particularly outrageous that Northwest Airlines is lobbying this issue so aggressively. Northwest is an airline heavy with debt from a leveraged buyout undertaken by Messrs. Wilson and Checchi. The LBO was undertaken to gain control of one of the most valuable franchises in aviation—very broad rights to fly to Tokyo from several points in the U.S. and to carry local traffic beyond Japan to many points in Asia. This valuable and anti-competitive system was granted to Northwest free of charge by the U.S. Government, in 1946. Despite having it, Northwest has complained incessantly about SABRE and is now telling its people that it cannot pay wages and benefits competitive with American, United and Delta. Senators, SABRE is not Northwest's problem. Northwest's management is Northwest's problem!

America West, the other leading complainant, has for years sought a scapegoat to divert attention from the failures of its management. But America West's problems have nothing to do with computer reservations systems. Its management knows it and its owner-employees know it.

A recent report prepared for the employees of America West by a respected consultant, a copy of which we have provided for the Committee, identifies the carrier's problems. SABRE did not force America West to purchase 747s. SABRE did not force America West to seek a route to Nagoya, Japan, which was a sure money loser from day one. SABRE did not force America West to abandon its focus on low-priced, point-to-point service nor to try to become a nationwide carrier. And SABRE most certainly did not induce Southwest, America West's prime competitor, to expand in Phoenix, on America West's home ground.

Mr. Chairman and Members of the Committee, enacting the legislation you are considering would be a great mistake. Deliberately damaging SABRE and COVIA will do nothing to help consumers, travel agents or the airline industry. To the contrary, it will reduce competition—by lowering the quality of information available to airline customers, and by demonstrating to entrepreneurs of every stripe that the U.S. Congress is willing to punish our economy's winners.

I urge you to turn your attention to doing those things that government can and should do. Our industry needs its government's help—and our government needs a healthy airline industry as well.

Thank you.

APPENDIX A

Section by Section Critique of S. 2312

1. *Functional Neutrality.* The Bill forbids any functional differences whatsoever as between one airline and another within any CRS. We support this objective, and whether there is or is not legislation, will eliminate the remaining minor "defaults" in SABRE within the next 10 months. By the Spring of 1993, we will also install in SABRE a function called "seamless connectivity." Utilizing the most advanced real-time interactive computer technology, "seamless connectivity" will allow travel agents immediate and simultaneous access to the internal reservations systems of any carrier that elects to participate. In short, for SABRE, neutrality is a done deal.

Today, all four CRS systems contain many so-called "defaults," all of which must be eliminated if such legislation is passed. This may impose a genuine financial burden on the smaller CRSs.

It is interesting that the very carriers that allege CRS "architectural bias" most loudly are the most aggressive users of travel agent overrides, which are extra payments made to travel agents to induce them to give the paying airline a premium share of bookings. CRS systems do not cause travel agents to book customers on a particular airline; overrides do. Thus, if Congress truly wishes to cause travel

agents to be indifferent as between Carrier A and Carrier B, it must mandate standard travelagent commissions, as the Civil Aeronautics Board did until 1982.

2. *The No-Host Requirement.* While the no-host requirement has been deleted from the proposed legislation, it deserves at least brief comment. As the concept appeared in S. 2312, this provision would have forced American to build a new, stand-alone computer center if it wished to stay in the CRS business. The additional costs would have penalized American but would have had no public policy benefit whatever.

The notion that separate facilities will have any impact on CRS functionality is simply wrong. A recent CRS demonstration, conducted by the House Public Works Committee, proved conclusively that hostless systems have no greater independence of their sponsor airlines than do shared systems. The only currently "hostless" CRS system, System One, includes numerous software-driven defaults to its owner, Continental Airlines, despite the fact that the system is run on computers physically separate from those running Continental's internal reservations system.

It is worth noting that although System One touts itself as being the only no-host system in the industry, it is operated as an integral part of Continental Airlines. In early April, when American's personnel responsible for disseminating fare data to CRSs sought to give System One's technical staff a tape containing our new Value Plan fare structure—so those fares could be available for immediate sale through all CRSs upon our announcement of our fares the next morning—we asked System One s people to agree not to disclose proprietary data to Continental or any other carrier. System One declined our request. System One's "hostless" system is anything but independent of its owner!

A requirement that CRSs be "hostless" would not accomplish anything beyond true functional neutrality. Its only purpose would be to penalize successful CRS competitors by imposing uneconomic operating requirements.

3. *Pervasive Regulation of Relations with Carrier Participants.* The new Bill is substantially worse than its predecessors in several respects. For one thing, it regulates booking fees and imposes regulation of many of the other terms and conditions of contracts between CRS vendors and CRS system participants.

The Bill includes a provision that mandates binding arbitration of CRS booking fees, but the scheme mandated by this Bill is not arbitration—it is a back-door means of regulating booking fees in a way designed to penalize efficient vendors.

The procedure provides that the arbitrator must "render a decision as to whether the disputed participant fees exceed that which would be fair and reasonable in light of the revenues and costs attributable to the computer reservations system", giving "due regard to all revenues of the vendor, including any air transportation revenues attributable to the computer reservations system of any air carrier holding an ownership interest in the computer reservations system, and all applicable costs, including an allowance for a reasonable return on investment."

This impressive charge is beyond the capacity of anyone, and is ludicrously intrusive. In what other industry are commercial transactions between multibillion dollar entities subject to arbitration over the "reasonableness" of the consideration involved? Will Congress also pass legislation allowing us to arbitrate the price we pay for fuel, or airplanes, or communications facilities, or advertising? Will caterers be compelled to arbitrate the amount they charge for food? In what industry are revenues earned by a primary business relevant to what the company charges its customers in an ancillary business? Electronic Data Systems' contracts for information services are not subject to arbitration based on General Motors revenues from car sales. Why should SABRE fees depend on airline ticket sales or cargo revenues?

Such intervention, if it actually occurs, will have any number of unexpected results. One that we can anticipate is the elimination of all research and development in the CRS industry. Such investments depend on the assumption that whatever is developed can be sold at a profit. Since there would be no way to determine what if any revenue value an arbitrator might assign, and since any increase in fees, no matter how minor, would trigger arbitration, why would any company ever seek to invent anything? This is a truly bizarre and unprecedented way to regulate commerce.

Moreover, there is no precedent in federal law for imposing such arbitration requirements. The law, as stated by the Supreme Court in *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 89 L. Ed 2d 648, 106 S. Ct. 1415, 1418 (1986), is clear: arbitration cannot be mandated. "A party cannot be required to submit to arbitration any dispute which he has not agreed so to submit. * * * [A]rbitrators derive their authority to resolve disputes only because the parties have agreed in advance to submit such grievances to arbitration." Thus, a statutory requirement that we arbitrate booking fees is illegal, as well as unprecedented and unjustified.

CRS booking fees are a minor airline expense. Carriers spend far more money on catering than on CRS booking fees. If Congress really believes that CRS fees should be regulated, then it should logically regulate all airline costs. The latter is obviously absurd; so is the former. The idea of regulating booking fees should simply be abandoned.

4. *Contract terms.* There are several provisions in the Bill that would impose statutory limitations on the terms and conditions of the contracts entered into between CRS vendors and travel agents.

The Bill would prohibit contracts with a term of more than two years, preclude liquidated damage provisions and proscribe minimum use—or volume discount—provisions. As far as we know, this would comprise the most intrusive and limiting set of federal statutory restraints ever imposed on commercial contracts. Many of the contract terms to be regulated have been litigated and upheld. Having lost in court, our competitors now turn to Congress.

In addition to having been upheld judicially, these provisions are common to contracts in other industries. There is no reason to treat CRS contracts any differently than contracts for other forms of office equipment. Unless Congress wishes to dictate the terms of computer leases generally, it should refrain from regulating arms-length CRS transactions.

APPENDIX B

Ninth Circuit Court Affirms CRS Ruling

Once again the federal courts have affirmed that the ownership of CRS's does not violate the antitrust laws. On October 29,1991, the Ninth Circuit Court of Appeals unanimously affirmed the summary judgment of the district court (91 Daily Journal D.A.R. 13279). On April 6, 1992, the U.S. Supreme Court denied certiorari (112 S. Ct. 1603(1992)).

We have heard repeated arguments from certain parties that owners of computer reservations systems (CRS's) have engaged in illegal and anti-trust behavior. These claims and other CRS issues have been litigated expensively.

The most comprehensive case was a private anti-trust action brought in California by various airlines against SABRE and Apollo. After a lengthy trial, the jury found in favor of SABRE and Apollo on all points.

Since many of these same arguments are being used to urge new and costly legislation of the industry, I thought it would be important to provide you with some information on this litigation.

Facts

In 1989, a trial was held in the Federal District Court in California concerning three claims brought against American Airlines and United Airlines by some of their competitors. In each claim, the plaintiffs argued that the ownership and control of CRS systems by American and United constituted violations of the Sherman Act. The trial court found that two of the three claims were so without merit that it granted summary judgment dismissing them. A jury considered the remaining claim and concluded there were no antitrust violations.

The plaintiffs appealed the summary judgment decision (but not the jury verdict). After arguments to the 9th Circuit in April, the Appeals Court affirmed the original decision and concluded that there have been no violations of the antitrust laws by owners of CRS systems.

Findings

The Court of Appeals found that CRS's are not "essential facilities" and that American and United have no engaged in "monopoly leveraging" of their CRS systems. Most important, the Court described the economics of the CRS business with unusual clarity. Specifically the court stated the following:

> "Airlines generally subscribe to every CRS because the CRS's charge the airline *per booking*. The $1.75 fee to secure a booking is of little consequence because a $300 or $400 fare may otherwise be lost. This is not to say that a CRS can charge its airline subscribers any fee that it desires, no matter how high. Basic economic theory tells us that an airline will withdraw from the CRS if the cost of using it causes the marginal cost of providing a flight booked on the CRS to exceed the marginal revenue gained by the booking." [emphasis in original text]

In a later portion of the decision, the Court reiterated this point in the following way:

"* * * Thus, the ability of United or American to abuse their downstream competitors by manipulating their CRS's is severely limited.

"Moreover, United and American have never refused any of the plaintiffs access to their respective CRS's. * * * Rather, United and American have always given all of their competitors in the air transportation market such access for a fee. Neither United nor American have ever set this fee at a level that would drive their competitors away. As noted above, it is unlikely that defendants would set their fee at such a level, for, if they did, they would destroy their CRS's rather than their competition."

This finding is consistent with every court action brought against the owners of CRS systems. This particular case involved the most detailed examination of the CRS business ever undertaken. Thousands of exhibits and weeks of trial affirmed that the CRS business is operated wholly within the parameters of the antitrust laws.

Now that those urging legislation of this industry have lost another round in court, they will likely renew their efforts to persuade Congress to do what the courts will not do. Those efforts should be rejected.

APPENDIX C

[Time, May 18, 1992]

THE BANKRUPTCY GAME

(All sorts of companies are taking refuge in chapter 11. But too many use the law to stiff creditors, enrich lawyers, and protect bad managers.)

(By John Greenwald)

According to the American capitalist gospel, it is no sin to go belly up. Quite to the contrary, U.S. firms enjoy the most liberal bankruptcy laws on earth—a privilege strengthened by a provision of the code known as Chapter 11 that holds creditors at bay while often allowing sick firms to bleed new buckets of red ink and still operate for years.

Congress added the Chapter 11 provision to the federal bankruptcy code in 1978 so companies could stay in business while working out repayment plans. But a national debate has now sprung up over whether the country would be better off if sick firms were allowed to die. Last year nearly 21,000 firms filed Chapter 11 petitions, the most since 1989. More significant, many of the new cases are mammoth, involving such familiar names as Macy's, TWA and Orion Pictures. While few large companies entered Chapter 11 before the mid-1989s, more than a dozen with assets exceeding $5 billion have taken refuge there in the past three years.

A growing body of critics charge that Chapter 11 has become a tool that wily managers can now use to stiff creditors and preserve their own jobs. Moreover, they argue, companies in Chapter 11 can take advantage of the fact that they pay no interest on part of their debt by slashing prices and wreaking havoc on their competitors. Most companies that take refuge in Chapter 11 ultimately fail anyway, critics say, leaving creditors with even fewer assets than if the firms had been liquidated in the first place. Says Sam Zell, a Chicago financier. "It isn't good for the economy to prop up cripples and hand them unfair advantages that allow them to bleed income and help destroy the healthy competition.

Horror stories are easy to find. Eastern Airlines had a net worth of more than $1 billion when it entered Chapter 11 in 1989. But there was little left for creditors by the time Eastern exhausted $400 million trying to remain aloft before it quit flying last year. Manville Corp. filed a 1982 petition solely to escape $2 billion of liability suits brought by defendants who claimed to have been harmed by the firm's asbestos products. The next year Frank Lorenzo steered Continental Airlines into bankruptcy, allegedly to break union contracts. But the tactic could not save Continental—now minus Lorenzo—from returning to Chapter 11 in 1990.

Alarmed by such abuses, Congress is considering reforms. The Senate Judiciary Committee has called for a blue-ribbon panel to study whether the entire 1,568-page bankruptcy code should be over-hauled. The panel would also consider speedy alternatives to Chapter 11 proceedings, which last about two years on average and force companies to expend vast sums of scarce cash on legal and accounting fees.

Many experts agree that changes in Chapter 11 are sorely needed. "Nobody thought It would ever come to this, Says Sam Giordano, executive director of the American Bankruptcy Institute, a clearinghouse for bankruptcy information. "The

law was meant to keep people employed and allow companies to be good corporate citizens, not allow bankruptcy to be a shield for purposes for which it was never intended. Right now," Giordano says, Chapter 11 "is just a hodgepodge that's being decided on a case-by-case basis. It's probably time to revisit the law itself."

A recent Yale Law Journal called for junking Chapter 11 altogether and letting sick companies die. The authors studied 326 publicly traded firms that had filed bankruptcy petitions between 1964 and 1989 and found that only 20 percent had managed to emerge successfully. At the same time, the article said, bond-holders lost 67 percent more of their investments on average when companies failed in Chapter 11 than under previous law. "If stock- and bondholders were worse off, what in the hell was going on here?" demands co-author Michael Bradley, a law and finance professor at the University of Michigan. "If the purpose of Chapter 11 was to protect corporate assets and shareholders, we found just the opposite."

Like any hotly contested issue, Chapter 11 has its share of champions. "On balance, Chapter 11 has been positive for the economy, says Edward Altman, a finance professor at New York University's Stern School of Business. "It conserves the assets and values of firms that have temporary problems but can be rehabilitated." Altman and doctoral student Edith Hotchkiss conducted a study that found that at least half the 1,096 firms entering Chapter 11 between 1979 and 1991 emerged successfully and have managed to stay out. That study focused exclusively on publicly held companies in Chapter 11.

Yet few experts dispute that Chapter 11 cases can run up huge—and often excessive—legal and professional fees, especially when big companies are involved. LTV Corp., a steel and aerospace conglomerate, which had sales of $6 billion last year, has forked out more than $100 million in legal fees since it entered Chapter 11 in 1986 yet remains mired in debt. As the megacase grinds on, LTV's bills are piling up at the astonishing rate of $2.5 million a month.

But owners and managers of companies in Chapter 11 can do very well for themselves, thank you, even as creditors take a beating. William Farley put his $3 billion empire, which includes Fruit-of-the-Loom apparel, into Chapter 11 last year. But analysts say Farley could keep a much as $100 million of his personal fortune and homes in Chicago, Aspen and Maine. In Washington, real estate developer Dominic Antonelli Jr. has reached agreement with his creditors in a $700 million Chapter 11 case that would allow him to keep, among other things, $1.9 million in cash along with stock, cars and possessions valued at $2.1 million. If the deal goes through, the creditors could get as little as 17 cents on the dollar.

Inside ailing companies, Chapter 11 filings can lower morale and strain already tense relations between bosses and employees. Some TWA workers question owner Carl Icahn's motives for placing the airline in Chapter 11 in January. Instead of striving to clean up the company's finances, they say, Icahn's real goal may be to use Chapter 11 as a shelter from which to conduct fare wars like his current battle with American Airlines. Chapter 11 can be a good opportunity for a company to cleanse itself of past mistakes, says Bill Compton, chairman of the pilots' union local at TWA. "But how do you do it when you have the same managers and employees who created the problems in the first place?"

Federated Department Stores emerged from two years of Chapter 11 proceedings in February after new managers shed $5 billion of the $8.2 billion of debt that previous owner Robert Campeau had accumulated. Federated—the parent of Bloomingdale's, Rich's, Burdines and other chains—spent much of the Chapter 11 period reorganizing its finances and closing weak stores. Macy's also got a new management look last month when chairman Edward Finkelstein resigned after filing Chapter 11 papers in January. Finkelstein had come under increasing fire since using debt to achieve a $8.7 billion buyout of Macy's in 1986 and another $1.1 billion to acquire Bullocks and I. Magnin stores.

Some firms have found it the best way to survive Chapter 11 is to escape it as swiftly as possible. The Days Inns motel chain brought 1,200 franchises out of Chapter 11 in January after a relatively brief 17-month stay. A lot of bankruptcies just go on forever," says John Snodgrass, who heads the franchise operations. "But the judge made sure we didn't get bogged down and drawn out. It really serves no one but attorneys to continue in bankruptcy for a lengthy period of time. It can't be healthy for a business to do that."

This commonsense approach is already working for small North Carolina companies. Under a fast track that U.S. bankruptcy Judge A. Thomas Small installed in 1987, firms file their reorganization plans within 90 days and average just six months in court. Spector Molding, a $3 billion plastics company, made an even quicker getaway; it was in and out at of Small's court in less than two months. "Cases like this are why the code was written," says Trawick Stubbs, the firm's at-

torney. "Congress has said, and I agree, that it's preferable to have reorganization and rehabilitation rather than liquidation."

Experts say big firms should speed through Chapter 11 in the same no-nonsense way. Chicago investor Zell would give companies an "absolute deadline" of one year to reorganize or go out of business. "By having little discipline, you create a huge playing field for a lot of ghouls to make a living," he says. "They're all feeding at the trough." For all the richness of his metaphors, Zell has a point. Tight deadlines could curb Chapter 11 abuses by encouraging companies to get out of court quickly and return to the business of surviving in the marketplace without life support. Or, if that's impossible, to close up shop and allow their creditors to split the remaining assets.

Senator FORD. Thank you, Mr. Crandall.

There has been a lot of discussion about the recent 10-day fare war and I understand yesterday Continental Airlines, and then America West jumped in also charging you with predatory pricing.

Can you explain, or will you explain American's action and what you can expect the results to be?

Mr. CRANDALL. I will be most happy to do so, Senator. First, just so everybody understands it, we have sued those carriers as well, seeking a declaratory judgment that our pricing actions are entirely legal.

I think it is important in understanding the events of the last week to go back to the fall of last year. In the fall of last year, and Senator Ford and Senator McCain and every other Senator that sits in the U.S. Congress has received thousands of complaints from air travelers and we have received thousands of complaints from air travelers, saying the airline pricing system is lunacy.

It is too complex. It is too convoluted. It is too full of rules. It is too complicated. It is not fair. In addition, Senators, it did not work. So, late last summer, having lost money for the preceding 2 years, we decided that a new fare structure, responsive to our customer's needs ought to be put in place and we studied that for about 6 months.

And on April 9 we announced a very simplified structure. There were four fares in that structure, first class, unrestricted coach, and two advanced purchase fares. All of those fares were materially lower than the fares which had previously been in place. It was our belief that we could get travelers traveling again and specifically that we could get business travelers traveling again if we reduced unrestricted fares.

We called that plan the value plan and we put it out there on April 9. At the press conference at which we announced the value pricing plan many people asked us, "What will you do if your competitors file lower fares?"

We said, "We will have no choice but to compete on price because that is the way the airline industry works, but when we compete on price, we will lower the price structure, we will not file individual special fares for subsets of the marketplace because that would go right back to the complexity that our customers say they do not like."

In the weeks following, many carriers filed fares lower than ours, TWA, Continental, U.S. Air, and in each case we matched those fare filings by reducing the level of the value plan fare structure.

On May 20 or thereabouts, the original April 9 structure came back into effect. Then on May 27 Northwest came along and filed its so-called Adults Fly Free or Kids Fly Free promotion. We had

no choice but to match. Thus, we were confronted with three choices. We could have abandoned the simplicity of our April 9 plan, thus reneging on our commitment to our customers, and if we did that, we could have simply matched the Adults Fly Free or Kids Fly Free.

We could have ignored the fare and if we had done so we think we would have lost a great deal of business, or we could make the 50-percent-off sale applicable to everyone and that is what we did.

And I have just heard Mr. Conway express some very adverse views regarding that fare, I wonder, Mr. Conway some years ago wrote an annual report in which he had something to say about 50-percent fares which America West was offering. And that comment in America West's annual report was that 50-percent fares were just a terrific deal and a wonderful thing and a great initiative.

So, it sounds to me as if a one-half off sale is a good idea when America West thinks of it, but a bad idea when American believes that that is the appropriate way to respond to a competitive initiative.

Senator FORD. You recommend, Mr. Crandall, that Congress pass legislation to allow increased foreign ownership of U.S. airlines, and I think you alluded to that in your statement. Do you think it is important to maintain control by U.S. citizens?

I think you said you favor more foreign ownership only if they allow us to do the same thing there that we are allowing here; that is, the level playing field aspect, I think.

But how important is it to maintain control by U.S. citizens?

Mr. CRANDALL. Senator, I truly believe that the airline business is one of those businesses that need not have any borders. I therefore think, subject to assurance that U.S. citizens will have a full opportunity to participate, that the globalization of the airline industry ought to be allowed to proceed and if foreign capital wants to buy into the U.S. airline business, I think it should be permitted to do so.

To the extent that there are any national defense or emergency airlift concerns, I think they could be provided for in the charter of a carrier operating airplanes within the United States.

But I see no reason to restrict the ownership of airlines, so long as U.S. citizens are allowed equivalent opportunities elsewhere.

Senator FORD. There has been a lot of talk today about CRS.

Mr. CRANDALL. Yes.

Senator FORD. And Sabre is yours, is it a separate company from American Airlines?

Mr. CRANDALL. It is a division of our company, Senator. It could be set up as a separate company. It operates as a division today.

Senator FORD. That is fine. Are profits from Sabre plowed back into the airline or the CRS or both?

Mr. CRANDALL. Both.

Senator FORD. Does Sabre charge the same booking fees to American as it would to any other carrier?

Mr. CRANDALL. Yes, sir, it does.

Senator FORD. Thank you.

Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Mr. Crandall, I appreciate very much you being here today and I appreciate your patience. I do not think that many of us thought this hearing would last as long as it did. Perhaps it is an indication of the gravity of the situation facing the airline industry today.

I would like to repeat again the admiration that I have for you and your airline. The success that you have enjoyed has been extremely impressive. I showed a chart earlier as to the amount of market share that American has acquired over the years and according to those figures you are now the largest airline in America, and the world. Is that correct? Where do you rank in the world, just out of curiosity?

Mr. CRANDALL. I think we are the largest in the world with the possible exception of Aeroflot, Senator, and none of us are sure anymore just where Aeroflot is.

Senator MCCAIN. If they are your competition, you are doing pretty well. And so I do want to repeat the admiration and respect for the efficient way that you conduct your business which is a true American success story.

I also would like to say that as to the actions that you recommend that the Government can take to assure participation by all aspirants, I am also largely in agreement with and I think that Chairman Ford is also.

Foreign investment, aggressive in aviation negotiations with other countries, all those, I think are excellent recommendations and that should be pursued both legislatively and administratively.

One of the areas that you talk about is compelling the FAA to eliminate the slot system now in place at JFK, Washington-National, LaGuardia and O'Hare. Slots were a temporary fix, et cetera.

You also made a recommendation at one time, I wonder if you still agree with that slots should just be bought and sold in the open market. Is that still your view?

Mr. CRANDALL. Of course, Senator, if the slot system were eliminated, and then there would not be anything to buy and sell because they would no longer be a shortage commodity. So long as they exist and are a shortage commodity, I believe that the marketplace is the best way to allocate any shortage commodity.

Senator MCCAIN. So, buying and selling the slots, short of elimination would be your recommendation?

Mr. CRANDALL. That is what we do today, although as I say, I feel very strongly that one of the very affirmative things that Congress can do to incentivize us all to compete in every market is to simply get rid of the slot system.

Senator MCCAIN. How many slots do you have roughly in those four airports, Mr. Crandall?

Mr. CRANDALL. Senator, I could not tell you, I can tell you where we rank. We are second on Chicago, United is first. We are second or third at LaGuardia, U.S. Air is first and I think Continental is second, but I am not sure of those numbers.

Senator MCCAIN. Hundreds of slots, would that be——

Mr. CRANDALL. Yes, because in Chicago for example there are—I think United has in round numbers, 850 slots and we have got round numbers, 700.

Senator MCCAIN. I see. How much did those slots cost American Airlines, Mr. Crandall?

Mr. CRANDALL. Well, the cost in recent years, we have been paying some very fancy prices for slots. Of course, in the early years when slots were first created, there was simply a slot created for each then existing operation and therefore they did not cost anything.

As they have begun to change hands, many of us have very substantial investments in slots.

Senator MCCAIN. But the estimates I have heard are that 80 or 90 percent of those slots that American has they got for free.

Mr. CRANDALL. No, I think that is too high, Senator. I think something on the order of 60 percent however would be right.

Senator MCCAIN. I see, so basically what happened was that a Government-owned and Government-taxpayer built in most cases facility was given for free, at least 50 percent of them, to American Airlines, which certainly was no fault of yours. You happened to be at the right place at the right time.

Mr. CRANDALL. I would only throw in one comment, Senator, and that is that the airport in Chicago like most airports in the United States are not built by the Government, they are built by the airlines and ultimately built by passengers because we service the bonds that are used to build those facilities. So, they are not really Government facilities.

Senator MCCAIN. Sure, and I would comment in response, you also aware, Mr. Crandall, that the facilities such as the FAA, the tower, the computers, the people that control the traffic, to the tunes of hundreds of millions of dollars, is taxpayer supplied?

Mr. CRANDALL. That is correct.

Senator MCCAIN. You were quoted several years ago as saying that if you had to unload your CRS or the airline, you would unload the airline and I know that you have denied making that statement. All of us are sorry from time to time, particularly us politicians. Remember Morris Udall's politician's prayer: "May the words we utter today be tender and sweet because tomorrow we may have to eat them."

But I hope that you would respond to whether that is an accurate——

Mr. CRANDALL. I do not recall every having denied saying it, Senator. [Laughter.]

Mr. CRANDALL. I hope that all who hear it would understand that it is a statement obviously made to demonstrate, to have an effect as opposed to reality. The two businesses are very different sizewise, but the fact of the matter is that the airline industry for many years has been the least profitable major business in the America, and the consequence is, had I had the ability to put my shareholders into a profitable business and withdraw from an unprofitable one, I would have done so and would do so today.

Senator MCCAIN. So, what you are saying to me is you said it for effect and you did not mean it or you said it for effect and meant it?

Mr. CRANDALL. I said it for effect and meant it within the context of a comparison between something very big and something very small. It is an obvious impossibility.

Senator MCCAIN. Thank you. And you do not believe that your CRS booking fees are unreasonable? I believe you said that in response to Chairman Ford.

Mr. CRANDALL. They are less than fees charges in Europe. They are less than fees charged by comparable vendors of similar services. I simply see no basis for the assumption that they are unreasonable.

Senator MCCAIN. Well, the basis that I have is the Department of Transportation who says that your booking fees are 2.3 times the average cost of providing the service and that they are unreasonable. They and the Department of Justice also concluded—as you know when you had a proposal, I use the proposal, for sharing of your system—that they felt that would be very unfair to the competition.

Mr. CRANDALL. No, I do not know that, Senator. What I know is that at the time the Department of Transportation was perfectly willing to accept the merger between Datus II which was the Delta system and Sabre.

The Justice Department never did specify why it objected. It said only, "we do not want to have anymore airline mergers." Thinking at the time and as I think the chairman does and as I do, that there were too many airline mergers in the 1980's.

The fact remains is, the Justice Department has never provided explicit data as to why it objected to that merger and I find it astounding that immediately after that effort which was really our effort to respond to critics, you and others that said we should divest ourselves, we tried to create an industry utility. The Justice Department would not let us do it. They immediately turned around and allowed Delta, Northwest, and TWA to form a three-way partnership to create a CRS system.

So, you got three airlines in one system as opposed to the industry utility we were trying to create. So, the fact of the matter is, I do not know to this day why the Justice Department did not permit that. I think it would have been procompetitive and I think it would have been a nifty way to create the industry utility CRS system which so many people seem to want.

Senator MCCAIN. I would be glad to get the Department of Justice's comments on that, but the fact is that there is a significant difference between your proposal and that of the other airlines.

In your testimony you commit American to eliminating all forms of bias by April 1, 1993.

Mr. CRANDALL. All forms of difference, Senator, that is right. We do not think there is any bias there today, but we propose to make the system absolutely the same in every respect, assuming of course that every other airline wants that to happen.

A small story may be illustrative. We recently offered the other airlines in the industry the ability to print their own frequent flyer numbers on boarding passes issued on their behalf by Sabre, interestingly, America West turned us down.

Senator MCCAIN. This legislation that I have proposed and which is basically the proposed rulemaking of the Department of Transportation is endorsed by the Consumer Federation of America, the Aviation Consumer Action Project, the American Society of Travel Agents, previous witness, and the Association of Retail Travel

Agents. In effect the people who use and distribute your services believe that reform is needed.

Tell me how they are misguided, Mr. Crandall.

Mr. CRANDALL. I think they are misguided in this respect, Senator: What is proposed in the legislation is not arbitration. It is in effect the regulation of booking fees. We are not talking about resolving a dispute. We are talking about allowing a third party to establish the price at which a vendor, American, will sell selected services to its customers.

We do not impose that kind of pricing regime on any other company in America. Automobile companies sell their products for whatever they choose to sell them for, steel companies, department stores, manufacturers of every ilk. In effect, that provision says that American cannot set the price of its product, that some third party who has no interest and certainly no capital investment is going to be allowed to set the price of a product we sell.

That is not arbitration, that is fixed rate, legislated pricing.

Senator MCCAIN. Obviously we have very different interpretations of what the legislation says because I would not support it as you describe it and I will try perhaps explain it to you in a more succinct or articulate fashion.

No one likes to make predictions, clearly in this climate in which we exist today, not economic but political. But your airline does have future plans which are dictated by the state of the industry—and if you choose not to respond, I would certainly understand—but I would ask for your prediction. Recognizing that we do not like to—Yogi Berra said we do not like to do that especially when we are talking about the future—but we want to try to get your view as to what the state of the airline industry will be 6 months or 1 or 2 years from now as far as the size of the domestic American airline industry is concerned.

Mr. CRANDALL. Are we talking about—as I said, in the first place, as I said in my testimony, neither I nor anybody can make that prediction with any accuracy and as you said and as one of our great homespun philosophers said, never made predictions especially about the future. So, I will therefore have to——

Senator MCCAIN. I thought I just said that.

Mr. CRANDALL. I would have to tell you, I do not know the answer. The economics of the business operate as I tried to set them out in both my oral and written testimony, I do not think we can have hundreds of airlines and I do not think we will have hundreds of airlines if we let the marketplace run its course.

Whether we will have four or five or eight I simply cannot tell you, but so long as you have an industry of many individual competitors who make individual pricing decisions, who are driven to sell any empty seat at the marginal cash cost and so long as every carrier perceives that it has to match every other carrier pricewise, I think you are going to evolve down toward some fewer number of carriers. What that number may be, I simply do not know.

Senator MCCAIN. When you say they are driven by one carrier, was that your explanation for American's action after Northwest?

Mr. CRANDALL. Exactly right. I said this is, the economics of the business are the way the economics of the business are. Consumers are extraordinarily price sensitive. They will move to the lowest

fare. Thus, the industry always moves toward matching the lowest fare, whoever files it.

The chairman was making a point with respect to Eastern. I made the point that 18 months, 2 years ago America West went out and had a 50-percent-off sale. There are sales and sales and more sales and the industry moves toward matching the lowest price whatever that lowest price that is filed may be.

Senator MCCAIN. Thank you very much, Mr. Crandall.

Thank you, Mr. Chairman.

Senator FORD. Mr. Crandall, there may be a couple of questions for the record and they will be submitted to you in writing.

We hope you will respond in a timely manner and this hearing is adjourned.

[Whereupon, at 1:15 p.m. the subcommittee was adjourned.]

APPENDIX

PREPARED STATEMENT OF SENATOR GORTON

Each of us here today has expressed concern at one time or another over the state of the airline industry. I am interested in the perspectives of the many witnesses here today on the subject of general airline competition because of its direct impact upon the consumer.

I believe the Subcommittee has taken an important step in addressing the concerns of the airline industry in conducting a hearing on S. 2312, the Airline Competition Enhancement Act of 1992. I hope that the results of the hearing will give the members of the Subcommittee additional insight into dealing with the important issues which confront the airline industry.

PREPARED STATEMENT OF SENATOR MIKULSKI

Mr. Chairman, I am opposed to S. 2312. In particular, I oppose the provision which would allow certain air carriers to bypass the rules limiting flights out of High Density Airports by using commuter slots as air carrier slots.

As a Senator from Maryland, I represent an area which is already suffering from severe noise problems because of the large number of flights from Washington National Airport.

The High Density Rule was put into place for airports like National which are located in heavily populated areas. It has two purposes: to try to limit aircraft noise and to ensure safety. It is against the public interest to loosen this rule, solely for the private interests of a few small air carriers.

I strongly hope you will not adopt this legislation, and I thank you for the opportunity to submit this testimony today.

PREPARED STATEMENT OF CONGRESSMAN MORAN

Mr. Chairman and Members of the subcommittee, thank you for allowing me the opportunity to provide testimony regarding an issue that is of the utmost importance to thousands of residents of Northern Virginia—the operation of Washington National Airport.

Our region does not object to the intent of this legislation, the Airline Competition Enhancement Act of 1992, which is to make air travel more competitive and more affordable. With the corporate attrition that has occurred in the airline industry over the past ten years, we should do all we can to maintain competition in an increasingly monopolistic industry. I am concerned, however, with including Washington National Airport in this legislation.

Currently, while National Airport is operating at a maximum safe capacity, the hundreds of arrivals and departures that utilize the facility daily have a significant impact on the surrounding area—whether it be the incessant noise, impact on local transportation resources, or the endless concern with safety.

The region regards any action by Congress or the Administration to eliminate the current limits on air-carrier operations at Washington National Airport as a serious breach of good faith with the metropolitan area local governments that supported the Metropolitan Washington Airports Act of 1986. Local jurisdiction's endorsement of that legislation was based on assurances written into the Act that the newly created Metropolitan Washington Airports Authority (MWAA) was prohibited from increasing the number of air-carrier instrument flight rule takeoffs and landings beyond the limits established by the FAA's High Density Rule. As the former Mayor of Alexandria, I can assure you that my city's endorsement of this legislation was based on the allowance of no more than 37 scheduled air carrier operations per hour.

Mr. Chairman, as you are aware, Washington National is in the midst of a $1.5 billion capital improvement program which was based on the operational parameters written into the Metropolitan Washington Airports Act of 1986. These facility improvements at Washington National are not designed to handle demands generated by scheduled air-carrier flight operations exceeding 37 per hour—which this legislation might possibly allow. While, again, I commend you and the subcommittee for addressing the issue of airline competition, I urge you to delete National Airport from any subsequent legislation.

Thank you for the opportunity to provide this testimony.

PREPARED STATEMENT OF CONGRESSMAN WOLF

Thank you for the opportunity to submit for the hearing record the attached letter to Transportation Secretary Andrew H. Card from the Washington area congressional delegation concerning the issue of increasing air carrier operations at Washington National Airport.

As expressed in our letter, we strongly oppose any increase in such operations, including the proposed use of commuter slots for air carrier operations as outlined in S. 2312.

Any increase in air carrier operations at National would have the following negative effects:

(1) Exacerbate the problem of noise for airport neighbors of this urban landlocked facility.

(2) Represent a breach of faith to all who participated in the negotiations six years ago transferring National and Washington Dulles International airports to a regional airports authority.

(3) Jeopardize the master plan and terminal design for National's ongoing capital program which is centered on the continuation of limited aircraft activity.

(4) Jeopardize nonstop air service to smaller communities only served by National, if such service were displaced by air carrier service to major markets.

JOINT LETTER FROM MEMBERS OF CONGRESS WOLF, MORELLA, MORAN, AND HOLMES-NORTON

APRIL 30, 1992.

The Honorable ANDREW H. CARD, JR.,
Department of Transportation,
Washington, DC 20590

DEAR MR. CARD: Since the Federal Aviation Administration (FAA) is in the final months of a rulemaking concerning capacity at high density controlled airports, we are writing to reiterate our adamant opposition to any increase in air carrier operations at Washington National Airport.

Last year, we objected to language which appeared in the September 13, 1991, issue of the Federal Register concerning the existence of additional capacity at National. This reference was included in a discussion accompanying the FAA's proposed amendments to the Aviation Safety and Capacity Expansion Act of 1990. In that discussion, the FAA indicated that there were formidable obstacles to capacity expansion at Kennedy, La Guardia and O'Hare airports due to airspace, runway configuration and noise sensitivities of surrounding communities. With regard to National, the FAA concluded, however, that "substantial capacity exists to add air carrier operations * * *"

Even though the FAA added the disclaimer that such an increase in air carrier operations at National is against the law, this discussion in the Federal Register prompted a news report claiming that FAA was recommending an increase in the slots at National. We were very pleased that then Transportation Secretary Samuel Skinner issued an immediate formal response that the FAA was not making such a recommendation.

However, the FAA's statement that "substantial capacity" exists at National continues to cause a great deal of public anxiety, particularly among the citizens living near National Airport. Equally disturbing is the recent testimony of the FAA before the House transportation appropriations subcommittee in response to questions. At that hearing on April 7, the FAA's legal counsel representing acting administrator Barry Harris declined to take a stand against an increase in slots at National, and stated, "Our mind is not made up because we are in the process of a current rulemaking consistent with a congressional mandate to be looking at all available alter-

natives to increase new entrants at high density controlled airports, National being one of them."

Residents of neighboring communities around National Airport have protested that the noise level is already too high, exacerbated by overflights from Washington Dulles international and Baltimore Washington International (BWI) airports as well as Andrews Air Force Base. They also believe that an increase in flights would decrease safety and they cite the same considerations, including runway configuration, prohibiting increased flights at New York and Chicago airports. They strongly believe there is no additional capacity and are supported by the Metropolitan Washington Airports Authority and state and local elected officials.

It is also important to recall that the flight limitations at National are part of the very delicate negotiations conducted five years ago which resulted in the transfer of National and Dulles airports-from the FAA to a regional airports authority. To increase air carrier operations at National now would be a breach of faith to all parties who agreed to the balance that was finally achieved.

While we understand you are currently involved in developing the final rule, we urge you to reconsider the FAA's current stance of neutrality in the question of flight limitations at National and indeed recommend against any increase in the so-called slots at this airport. We understand that your mission is to increase competition at airports for the good of the nation's travelers, but this must not be done at the cost of the safety and health of National Airport's neighbors.

Thank you for your consideration and we look forward to your response.

FRANK R. WOLF,
Member of Congress.
CONSTANCE A. MORELLA,
Member of Congress.
JAMES P. MORAN,
Member of Congress.
ELEANOR HOLMES-NORTON,
Member of Congress.

PREPARED STATEMENT OF THE METROPOLITAN WASHINGTON AIRPORTS AUTHORITY

The Metropolitan Washington Airports Authority (Airports Authority) respectfully offers for the record its views on S. 2312 "The Airline Competition Enhancement Act of 1992" to enhance competition at, and the provision of essential air service with respect to high density airports, and for other purposes.

S. 2312 proposes to amend the Federal Aviation Act of 1958 with respect to: 1) Measures to increase competition among commercial air carriers at major airports; 2) the selection of air carriers to provide small community air service at high density airports; 3) the transfer of slots at high density airports; and 4) operational restrictions on airline computer reservation systems.

The portion of the Airline Competition Enhancement Act of 1992 that is of most concern to the Airports Authority is Section 420—Use of Commuter and Air Carrier Slots by New Entrants at High Density Airports. This section would amend the Federal Aviation Act of 1958 to allow an air carrier having less than 12 air carrier slots to carry out air carrier operations at a high density airport to also use commuter slots as air carrier slots. This legislation provides that an air carrier using commuter slots as air carrier slots at a high density airport may not use, in the aggregate, more than 12 slots in a twenty-four hour period.

The Airports Authority opposes this approach. We believe that air carriers seeking to enter the market at Washington National Airport or to increase their operations at Washington National Airport have legitimate and ample opportunities to acquire slots via the buy/sell mechanism in the current Federal Aviation Administration rules. A recent example is the transfer of slots at National between Northwest and USAir. We do not believe that these rules need to be changed except to put more stringent use or lose requirements on slot holders. We encourage the Congress to let the current review by the Federal Aviation Administration of the High Density Rule address this issue through means such as the application of more stringent requirements for slot use and for the withdrawal of slots from air carriers that fail to meet the slot use requirements.

Since 1966 there have been limitations on scheduled aircraft activity at Washington National Airport. Currently, with the agreement of Congress, the Federal Aviation Administration, the Commonwealth of Virginia, the District of Columbia and the concern of individual jurisdictions surrounding Washington National Airport, air carrier schedules are restricted to 37 per hour at Washington National Airport. This restriction is also embodied in the Metropolitan Washington Airports Act of 1986

(49 U.S.C. §2458(e)) and in the Nigh Density Rule. While S. 2312 does not propose increasing the total number of slots available at high density airports it would allow for an increase in the number of air carrier operations at high density airports. To amend the Act to allow for an increase in air carrier operations would have a significant and detrimental impact on operations, the environment and commuter air service at Washington National Airport.

The Airports Authority is currently in the process of rehabilitating the facilities at Washington National Airport. A significant increase in the number of air carrier operations, which were not accounted for in our planning, would adversely affect our redevelopment efforts. Extensive Master Plans have been developed and a terminal design has been selected. Underlying all this are the necessary assumptions that aircraft activity at Washington National Airport would remain limited as agreed by Congress and as fostered by the compromise in the Metropolitan Washington Airports Act of 1986. This legislation would make it likely that even the planned improvements would be insufficient to adequately meet the demands for airfield, terminal, parking and roadway facilities. Consequently, even after the rehabilitation project air carrier, general aviation users and commuter air carriers would be operating in a congested environment as the demands of increased numbers of larger aircraft are met. This could result in delays to passenger more frequently encountered at other airports but, to date, not encountered at National.

There will also be an environmental impact from this legislation. An increase in commercial air carriers will only exacerbate the problem of those exposed to aircraft noise. The existing Rule, though not adopted as a noise rule, has had a very real and beneficial effect on aircraft noise exposure resulting from operations at Washington National Airport.

Air service between Washington, DC and many important, but smaller, communities is likely to be affected by this legislation. The majority of commuter destinations served by commuter airlines operating out of Washington National Airport have no other available non-stop air service to Washington, DC. There are currently a total of 27 non-stop destinations served by Washington National Airport commuter airlines. Destinations served include Bridgeport, Connecticut; White Plains, Newburgh and Elmira, New York; Trenton, New Jersey; Norfolk, Richmond and Roanoke, Virginia; Allentown and Harrisburg, Pennsylvania; Salisbury, Maryland; Jacksonville and Greensboro, North Carolina; Clarksburg and Morgantown, West Virginia; and Lexington, Kentucky. To take away air service to destinations only served non-stop out of Washington National Airport by commuter airlines to provide for additional commercial air carrier slots to larger markets may have an adverse impact on air service to the Nation's Capital for many smaller communities. This is especially inappropriate when there appears to be an adequate number of air carrier slots available to respond to the demand of air travelers.

In closing, we encourage the Congress to allow the Federal Aviation Administration to address the concerns of the industry regarding available slots for commercial air carriers at high density airports through the review of the High Density Rule that is currently underway. We ask the Senate to recognize that the High Density Rule is very significant to Washington National Airport and its environs. The limitations have become a fundamental principle on which significant airport, air carrier, and community planning decisions have been based. We urge that the legislation authorizing the use of commuter slots by air carriers for large aircraft operations not be enacted.

PREPARED STATEMENT OF GREGORY A. CONLEY, VICE PRESIDENT AND GENERAL COUNSEL, COVIA PARTNERSHIP

Chairman Ford and Members of the Subcommittee, Covia Partnership appreciates the opportunity to provide testimony concerning the provisions of S. 2312 involving airline computer reservations systems ("CRS"), as modified by Amendment No. 1867 submitted by the sponsors on June 4, 1992.[1]

COVIA PARTNERSHIP

Covia Partnership owns and operates the Apollo CRS. The Apollo system was formerly owned by United Air Lines, but in 1988 United sold interests in Covia to a number of other carriers. At this time there are seven Covia partners. A United subsidiary owns half of the partnership interests; the other partners are subsidiaries of USAir, British Airways, Swissair, KLM, Alitalia, and Air Canada.

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[1] This is the testimony of Covia Partnership. It is not offered on behalf of the individual Covia partners.

The Apollo CRS is not an adjunct of United Air Lines, as some critics like to suggest. Covia is operated as an independent business. Covia's owners expect the company to earn profits on a stand-alone basis; Covia receives no subsidies from any of its airline owners. Covia has its own officers and employees, who operate the Apollo system on a day-to-day basis. A large number of Covia employees do not have an airline background. Moreover, Covia's owners have deliberately sought leadership from outside the airlines. For example, Covia's President and Chief Executive Officer, Allan Loren, was formerly the head of United States operations for Apple Computer.

Apollo has always been the second largest CRS, considerably behind American Airlines' SABRE system. Nevertheless, Covia has been a leader in technical innovation. One example is Covia's early placement of intelligent work stations in travel agencies. Covia is also a leader in the development of network services and computer-to-computer link technology. Covia is, and has been since the introduction of Apollo into travel agencies, further improving Apollo functionality for travel agencies and travel vendors. This has been a continuous effort driven by marketplace demands and Covia's desire to offer the best CRS product in the world. It has also been an expensive effort—investment in Apollo totals over $1.3 billion.

Covia has been in the forefront of CRS technology on a global basis. Covia provides technology for Galileo, a European CRS based in Swindon, England, and for the Gemini system in Canada. Covia also markets Apollo in Japan and other parts of the Far East.

Covia is now in the process of taking CRS globalization one step further. Since 1988 there has been close to a 90 percent overlap in the ownership of Covia and the Galileo CRS in Europe. On March 5, 1992, the owners of Covia and Galileo announced their execution of a letter of intent to merge the two companies. United Air Lines' ownership in the merged company will drop to 38 percent. The Galileo-Covia merger represents a definitive response to a growing marketplace demand for the development of global CRSs. The merger also represents a logical step forward in extending the current relationship between the two companies, which has included shared product development, operations support, and marketing initiatives.

OVERVIEW

The push to impose broad and burdensome regulation on the CRS business is seriously misguided. The proposed legislation rests on highly erroneous and unsupportable assumptions about the role of the CRS business in relation to airline competition and the nature of CRS competition. Moreover, the legislation is in large part the product of pressures from dissatisfied competitors seeking economic and marketing advantages and from those who prefer to avoid paying a fair price for highly valuable services.

Covia has been working diligently to get the facts to Congress. Covia encourages the Subcommittee members and staff to read this statement carefully. Covia would also welcome an opportunity to meet with the Subcommittee to respond to any questions. Once the Subcommittee reviews the facts, it will conclude that CRS legislation is neither necessary or appropriate.

A. Airline Competition

While the stated purpose of S. 2312 is to increase airline competition, the CRS provisions of the bill will have no such effect. CRS vendors are not to blame for the financial woes of domestic airlines. CRS is not responsible for the failures and bankruptcies of specific carriers, the increases in fuel and airline labor costs, mismanagement, costly acquisitions of unprofitable equipment and routes, or the mergers and acquisitions that have reduced the number of domestic airlines. While some have tried to use CRSs as whipping boys for all of the airline industry's woes, the facts simply do not bear this out.

To the contrary, CRS is one of the most procompetitive developments in the history of the airline business. CRS fosters increased airline competition, not concentration. CRS is the reason new airline entrants can immediately get their products in front of the people who sell them, without any up-front costs. Deregulation, with the entry of so many new carriers, could never have taken off so quickly without CRS. Moreover, CRS promotes and facilitates a carrier's ability to provide a prompt competitive response to the fare and schedule changes of its competitors.

There are many beneficiaries of CRS services. CRS has given airlines the most comprehensive, flexible and cost-effective distribution capability of any business in the world. Airlines and other travel vendors receive enormous value in exchange for relatively modest CRS fees. CRS has also dramatically increased the efficiency and lowered the operating costs of travel agents. Finally, CRS has brought great benefits

to consumers. CRS ensures that travelers will have access to the lowest fares and the most convenient flights available.

B. CRS Competition

There can be no question that the CRS business itself is intensely competitive. The claim by some critics that CRS is a monopoly market is completely unsupportable. First, the pace of technological innovation in the CRS business has been rapid and sustained. In its 1988 CRS study (p. 28), and again in its 1990 Task Force Report (pp. 95-98), the Department of Transportation recognized that CRS vendors compete vigorously to enhance their systems. That continues to be the case today.

Second, there is very strong competition among the four U.S. vendors[2] for travel agent subscribers. The DOT recognized in its 1988 CRS Study (pp. 33-34) that CRS vendors were engaged in a "conversion war" and that, as a result, travel agents were able to negotiate highly favorable contracts. Apollo agents frequently receive buyout offers from other vendors. Covia often responds by lowering the agent's lease fee and offering additional financial incentives for the agent to stay with Apollo. As a result, discounts on travel agent lease fees have increased very significantly and continue to deepen. The systemwide average discount on Apollo lease fees is now over 80 percent, compared with 66 percent in the fall of 1989. Since 1989 Covia's annual revenue from travel agents has dropped from approximately $120 million to an expected 1992 level of approximately $8 million. We believe such fees will go negative in 1993 (i.e., on a systematic basis CRS vendors will be forced by the competitive marketplace to pay travel agents to use their systems).

Finally, from late 1984 to mid-1990 the basic Apollo booking fee did not increase, not even to account for inflation. The fee actually decreased by about 20 percent in real terms during this period of more than five years.

These are not the characteristics of a monopolized market. In a monopolized market, at a minimum one would expect to see travel agents paying increasingly higher above-market rates for CRS services each year, frequent large increases in above-market-rate booking fees charged to airlines, and very little or no investment in new features or enhancements. The facts demonstrate that, contrary to the rhetoric, the CRS business is driven by vigorous competition.

THE PROPOSED LEGISLATION

S. 2312 would (a) prohibit CRSs from maintaining any differences in functionality for host carriers and non-host carriers within two years, (b) require CRS vendors to permit installation of third-party hardware and software and to permit access to other data bases ("multi-access"), (c) prohibit certain subscriber contract provisions, and (d) establish an arbitration procedure to determine the appropriate level of CRS booking fees. None of these measures is necessary, and the premises on which they are based are simply wrong. Moreover, most of the proposals are bad for consumers of air transportation, for travel agents, and for CRS technology.

A. "Equal Functionality" and "Multi-Access"

1. The Premise: The Myth of "Architectural Bias"

The "equal functionality" and "multi-access" requirements of S. 2312 are grounded on the mistaken and unsupportable assumption that CRSs provide incomplete or inferior functionality for airlines that are not "hosted" in the system and that this results in travel agents being influenced to put their customers on airlines they would not otherwise have selected. This so-called "architectural bias" is a myth, which cannot be substantiated by any of its proponents.[3]

Current Department of Transportation rules prohibit carrier-specific display screen bias, and no one seriously argues that such bias exists in today's CRSs. However, some critics (in particular, the smaller CRS vendors) have claimed that "architectural bias" represents a justification for requiring "equal functionality."

There is no "architectural bias" in Apollo. The process of booking a flight on a participating carrier is the same as that of booking a flight on United. No additional keystrokes are needed, and the response in each case is virtually instantaneous. Apollo started out as the internal reservation system of United Air Lines. However, over the years millions of dollars have been spent on improving Apollo capabilities for carriers other than United. This includes provision of boarding passes, seat as-

[2] In addition to Apollo and SABRE, the U.S. vendors include Worldspan (owned by Delta Airlines, Northwest Airlines, and TWA) and System One (owned by Continental Airlines).

[3] At a demonstration session held for the House Aviation Subcommittee on March 10 of this year, the "architectural bias" proponents were given an opportunity to come forward with examples. No examples of "architectural bias" in Apollo were offered.

signments, and fare quote capability, improvements in message handling, and expansion of storage capacity for fare information, connect points, classes of service, and many other categories of information. Apollo would have failed in the CRS marketplace if Covia had ignored travel agency demands for a fully functional system that provides for easy and reliable bookings on any participating airline.

For this very reason, Covia was a pioneer in the development of computer-to-computer links with the internal reservation systems of other carriers, an effort that began in 1983 with a link between Apollo and Delta Airlines. This feature, known as Inside Link, functions as a direct pipeline from Apollo agents to the participating carrier; it enables the agent to make a booking directly in the carrier's internal system and to get any seat or fare that is available there. There are now more than 100 carriers (including most of the major carriers) whose internal inventories are available through Inside Link. Inside Link is easy to use and highly reliable. An agent using the Apollo basic display can make an Inside Link booking, communicating directly with the carrier's internal system, without any extra keystrokes. The confirmation message from the participating carrier comes back to the agent almost instantaneously. Inside Link capability is completely inconsistent with the whole notion of "architectural bias."[4]

Over the years, virtually all features of Apollo have been enhanced so that all participating carriers can have functionality that is equal to that of United. In recent years, only a few meaningless features that have no effect on travel agency bookings have continued to include a "host default" (i.e., where the travel agent failed to enter a carrier code Apollo assumed that the agent was requesting information on a United flight). For example, Apollo's FLIFO feature (which allows a travel agent to check the status of a flight on a same-day basis to see whether, for example, the flight has been delayed by bad weather) included a host default. This default could not possibly have affected booking choices; any agent using the FLIFO feature would be seeking information on a specific, previously identified flight.[5] If such "host defaults" had been at all significant, they would have been removed in response to travel agent complaints. Despite the absence of such complaints, the incessant litany of those who allege "architectural bias" ultimately persuaded Covia to divert time and resources to eliminating the few meaningless defaults, and it has done so.

In the real world, travel agents and air carriers have shown little interest in the supposed advantages of "host bias." During 1990 and 1991 Covia attempted to interest several carriers in being hosted in Apollo, but these contacts produced no hosting business for Covia. Apparently being hosted in Apollo is not such a great advantage as others have claimed.

The allegations that CRSs generate huge incremental airline revenues for their owners as a result of "architectural bias" are not consistent with reality. Covia does not base any of its business plans on a premise that any such revenues exist. In deciding whether it is worthwhile to automate an agency with Apollo, Covia considers only CRS revenues, i.e., booking fees and fees from travel agents. As noted above, no Covia owner subsidizes Covia's operations in recognition of any such incremental revenue.

In this connection, the Subcommittee should consider the reality of Covia's situation. Covia has six airline owners in addition to United, all of which purchased their interests with the expectation that they would earn a return. None of these owners would stand by while Apollo was manipulated to produce incremental revenues for United. The point applies with even greater force to the merged Galileo-Covia company, which will have nearly double the number of owners.

The data that have previously been offered in support of the theory do not prove the existence of any incremental airline revenues attributable to CRS. Indeed, figures offered by a System One official in testimony before the House Aviation Subcommittee last year showed that travel agents using System One (a CRS with no host since the demise of Eastern Airlines and thus, presumably, no "architectural bias") booked a disproportionately high share of their customers on Continental Airlines. This suggests that something other than "architectural bias" is at work—perhaps something as simple as the common sense proposition that travel agents that

[4] Northwest Airlines is the only major carrier that refuses to participate fully in Apollo's Inside Link feature—apparently so it can maintain a competitive advantage in marketing its own CRS, Worldspan, to travel agents in Northwest's hub markets. By withholding full participation in Inside Link, Northwest and Worldspan representatives can (and do) tout World-span as the only CRS with last seat availability on Northwest. Given Northwest's refusal even to use the functionality already available today, it is indeed ironic that it has been perhaps the most vocal advocate of "dehosting."

[5] It is clear from the demonstration session held for the House Aviation Subcommittee earlier this year that it is only trivia of this sort that underlies the claims of "architectural bias."

already have a strong relationship with a carrier tend to choose the CRS marketed by that carrier's sales force.[6]

Covia urges the Subcommittee and its staff to visit Covia's computer center in Denver and learn more about Apollo. Indeed, we would be happy to meet with the Subcommittee and its staff at any time in any location. We would like to demonstrate to the Subcommittee the superior functionality the Apollo system offers for all participating carriers. We believe that once the Subcommittee sees Apollo in operation it will conclude, as we do, that "architectural bias" is a myth.

2. The Proposed "Equal Functionality" Requirement

Because the Apollo system currently provides host and non-host carriers with equal functionality, Covia does not object in principle to the proposed equal functionality requirement. It seems clear, however, that such a requirement is unnecessary and would therefore impose needless administrative burdens on vendors and the Department of Transportation. At a minimum, the proposed legislation would require vendors and the Department to engage in unnecessary record-keeping and reporting exercises. Moreover, as a practical matter, the Department would be required to mediate disputes about which technological alternatives are more effective and who should pay the cost of making particular enhancements. Leaving such matters to the marketplace is far preferable.

3. The Proposed "Multi-Access" Requirement

Covia applauds the sponsors' decision to drop the "dehosting" requirement from S. 2312.[7] Covia had previously estimated that "dehosting" Apollo would cost tens of millions of dollars, without improving functionality. Most of this cost would have to be passed on to travel agents, airlines, and ultimately consumers of air transportation. In its March 1992 report, the General Accounting Office concluded that data on the functional effect of "dehosting" and the cost of such an undertaking were inconclusive, making it impossible for the GAO to determine "whether the competitive advantages of dehosting are commensurate with its costs."[8]

At the same time they drop the "dehosting" requirement, however, the sponsors of S. 2312 have added a provision that apparently is intended to impose a "multi-access" requirement (i.e., a requirement that vendors permit travel agents to access any CRS through their terminals). The costs and detriments of such a proposal far outweigh any possible benefits.

Prior experience suggests that there will be little demand for multi-access systems, particularly since agents have access to features such as Covia's Inside Link, which permits the agent to book directly in the system of any carrier that elects to participate. Reports in the trade press suggest that most agents will not be interested in multi-access, particularly if it entails additional costs.[9]

Multi-access capability is certain to be more costly and less convenient than today's single-access systems. There are many different possible approaches, but even the most basic multi-access system would require additional hardware, communications lines, and software development. Even if only a few agents elected to have this capability, CRS vendors would be required to spend substantial time and resources on development of the option. The additional expense would inevitably increase bottom line costs for airlines, travel agents, and air transportation consumers.

There would be many problems to solve in order to implement "multi-access"—including the need for greater processing and storage capacity, choice of the type of "gateway" and switch equipment to be used, development of compatible control languages, allocation of customer service responsibility, and choice between more expensive dedicated lines and less convenient dial-up capability, to name only a few.

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[6] The General Accounting Office has recently noted that the Department of Transportation has not gathered the sort of data that might be relevant to incremental revenue allegations, i.e., data on booking patterns by individual travel agents. U.S. General Accounting Office, Computer Reservation Systems: Action Needed to Better Monitor the CRS Industry and Eliminate CRS Biases, No. B-247612 (Mar. 1992) ("GAO Report"), p. 16.

[7] Covia has long regarded any "dehosting" proposal as essentially an effort to provide a competitive advantage to Northwest Airlines and its CRS company, Worldspan, which is engaged in building a new CRS system. Requiring other vendors to engage in "dehosting" over the next few years would divert the attention and resources of the larger CRSs from market-driven developments during the Worldspan start-up period, thereby giving Worldspan "catch-up" time.

[8] GAO Report, p. 16.

[9] See Robinson, "Agents Opposed to New CRS 'Freedom' If Costs Increase, Survey Finds," Travel Agent, Apr. 15, 1991, pp. 1, 4; Leiser, "Agent Challenges Transportation Department's CRS Proposals," Travel Agent, May 27, 1991, p. 2. Multi-access systems are generally less popular with travel agents than single-access systems, because they are considered to be relatively inconvenient. In the past, agents have been quick to abandon multi-access systems when more sophisticated single access systems have become available.

The work needed to bring about an effective multi-access environment (i.e., one that would be almost as convenient as today's single access systems) would divert attention from those technological developments for which there is a market demand. Ultimately, the need for universal compatibility among CRSs could lead to a "lowest common denominator" technology.

In the past the marketplace has driven CRS vendors to engage in substantial technological innovation, and that continues to be the case. The marketplace, if left to operate freely, will continue to generate pressure for additional enhancement of the systems. This free market dynamic—rather than artificial imposition of "multi-access" or some other technological agenda—is the best approach.

B. Limitations on Travel Agent Choices

1. The Premise: The Myth of "Restrictive" Travel Agent Contracts

Underlying most of the proposed limitations involving travel agents is the assumption that certain provisions in travel agency subscriber contracts prevent agencies from switching systems. In the real world, however, many agencies switch systems. In June 1990 Travel Weekly reported that nearly 1 in 10 agents had switched automation vendors in the preceding two years, despite all the practical problems associated with such a change (for example, the need to retrain staff).

Covia's contracts with travel agent subscribers include several provisions, including five-year terms and modest minimum use requirements, that are designed to ensure that an agent will use Apollo enough to generate a minimum level of booking fee revenue for Covia."[10] There is nothing odd about a CRS vendor wanting to make sure that the system will be used so that the vendor receives a return from its investment. Such provisions also benefit agents. Longer contract terms and assurance that an agent will actually use Apollo allow Covia to offer the agent a lower price.

Covia's contracts also include liquidated damages provisions. These clauses ensure that Covia can recover at least a portion of the revenues it was likely to receive under the contract in the event a subscriber chooses to terminate prematurely. Use of liquidated damages provisions is a common practice in many industries. Such clauses serve important business purposes by avoiding the need for difficult and costly damages calculations and by providing certainty to the parties in the event of a breach.[11]

The Covia contract provisions have not prevented Apollo agents from using multiple systems. Measured on the basis of Airline Reporting Corporation (ARC) revenue, more than 20 percent of the Apollo subscriber base uses one or more other CRSs on an active basis at the same time. The Apollo provisions also do not prevent agents from switching systems. The CRS business is so competitive that other vendors continuously offer to buy out Apollo contracts. Covia must then respond by offering the agent additional financial incentives to stay with Apollo.

Both the DOT's Enforcement Office and the courts have examined Covia's contract provisions closely and have found no evidence that they prevent a travel agency from using a second CRS if it wishes to do so.[12] The federal court of appeals in New York City also has observed that the Apollo liquidated damages provisions "edge closer toward over-generousness" to the travel agency than they do toward unreasonableness.[13]

Moreover, the existence of a liquidated damages formula undoubtedly makes it easier for competitors to buy out an Apollo contract.[14] The fact remains that a substantial number of travel agencies do change CRSs, and many Apollo agencies use another CRS in addition to Apollo.

2. The Proposed Limitations on Subscriber Contracts

The proposed limitations on travel agent contract provisions are not in the best interests of either CRS vendors or travel agents. Since existing provisions do not diminish the ability of agents to use multiple systems and to switch systems, there is no need for such legislation. Moreover, the proposed limitations would upset busi-

[10] Covia's minimum use provision is quite modest. It requires an agent to use Apollo at only half the rate of the agent's own level of Apollo usage during the first six months of the contract term. Under this formula, it is the travel agent, not Covia, that establishes the minimum use level.

[11] See, e.g., *Priebe & Sons, Inc.* v. *United States*, 332 U.S. 407, 411 (1947).

[12] See, e.g., Department of Transportation Order No. 90-1-32 (Jan. 17, 1990), pp. 17-18; In re "Apollo" Air Passenger Computer Reservation System (CRS), 720 F. Supp. 1061, 1065 (S.D.N.Y. 1989).

[13] *United Air Lines, Inc.* v. *Austin Travel Corp.*, 867 F.2d 737, 740-41 (2d Cir. 1989).

[14] The Department of Justice has recognized that liquidated damages provisions may have this procompetitive effect. 1985 Report of the Department of Justice to Congress on the Airline Computer Reservation System Industry, pp. 26-27.

ness relationships that have worked efficiently and to the benefit of both vendors and travel agents.

If contracts were limited to three years (as the legislation provides), vendors could not count on being able to spread the costs of installing the system over a longer period or on earning as much revenue from the agent's use of the system. In addition, if a minimum use requirement could not be included, vendors could not count on receiving booking fees; an agent would be free to allow the vendor's equipment to remain idle. As a result of such limitations, fees charged to travel agents would almost certainly rise to compensate for the vendors' inability to ensure a reliable stream of booking fee revenue. The proposed prohibition on recovery of damages that compensate vendors for loss of booking fees due to a breach of contract would have a similar effect.

Small travel agencies would be hurt the most by these prohibitions, since vendors would face the greatest uncertainty with such agencies. Travel agencies should at least have the freedom to choose a longer contract term, a reasonable minimum use commitment (such as the modest requirement Covia currently uses), and a liquidated damages Provision that includes a component for lost booking fees as a way of obtaining a lower CRS price.

The Subcommittee should be aware that some travel agents have opposed similar limitations on various subscriber contract terms in comments filed in connection with the Department of Transportation's CRS rulemaking.[15] These agents have made clear that they want the option to exchange contract terms for lower prices. See also Abels, "Should the Feds Provide More or Less Regulation of the Airline CRS Systems," Travel Trade News Edition, Apr. 13, 1992, p. 1 (reporting that travel agents responding to an opinion poll "voted overwhelmingly" against additional CRS regulation). In other words, many travel agents want competition to prevail.

It is also important to note that Covia has paid millions of dollars in upfront financial assistance to travel agents and has agreed to deeply discounted lease fees under its current contracts on the understanding that these agents would use Apollo under the existing contract terms. If Congress now permitted agents to walk away from these obligations, there would be an enormous loss for Covia and an enormous windfall for the agents. At the very least, all existing contracts must be grandfathered.

One other provision of S. 2312 would limit travel agent (and consumer) choices in an unacceptable way, by preventing travel agents from serving their customers efficiently. This provision would prohibit CRSs from providing agents with the capability of creating a carrier preference display, even where a customer advises her travel agent that she wishes to fly on a particular carrier due to personal preference, frequent flyer program incentives, or other factors. Covia has provided travel agents with such a capability, and it has proved quite popular. The proposed legislation allows an agent to modify displays in this manner only where a customer has submitted a written request in advance. This sort of intrusion into the ability of a travel agency to run its business in an efficient and customer-focused way should be widely and vigorously opposed by the travel agency community.

C. Booking Fee Arbitration

1. The Premise: The Myth of Apollo Profitability

The proposal for arbitration of CRS booking fee increases is grounded on the assumption that CRS vendors are earning extravagant profits by charging supracompetitive booking fees. These estimates of profitability are wildly exaggerated, at least for Covia.

Although substantial profits would certainly not be out of line in a business like CRS, with its rapidly changing technology and high capital investment requirements, Covia's profits have been in the range of, or lower than, profits of other companies in the data processing and communications fields. Moreover, Covia's operating profits have been shrinking steadily in recent years. In 1989, for all its lines of business, Covia earned $90.7 million in pretax net income; this figure dropped to $32.4 million in 1990; and by 1991, pretax net income was $15.3 million. During the last 18 months, financial pressures have forced Covia to take the painful step of reducing its work force by over 20 percent.

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[15] See, e.g., Comments of American Express Travel Related Services (June 24, 1991), pp. 8-10; Comments of Thomas Cook Travel (June 26, 1991); Joint Comments of Ten Major Travel Agencies (June 24, 1991), pp. 19-22; Comments of American Automobile Association, Inc. (June 24, 1991), pp. 4, 6-7 (opposing the proposed prohibition on minimum use provisions and supporting a three-year term only for renewals). See also Wallace, "DOT Rules: Flexibility at a Price to Agents," Travel Weekly, June 24, 1991, p. 26.

On the other hand, customers have received greater value for the money over time. The Apollo system provides at least 50 percent more functionality than it did six years age; in other words, the system provides 50 percent more services for every booking made. Apollo offers a wider range of customized information and services; today agents can more easily and reliably identify the best fare from a myriad of complex fare offerings, obtain the last available seat for a customer, and much more. This enables agents to provide a far higher level of service to customers today than in 1986. This in turn means that airlines and other travel vendors are receiving a much higher level of service from Apollo. Nevertheless, revenues from Apollo operations are shrinking in real terms. At the same time, our costs are rising steadily. In order to remain competitive, Covia must make massive capital investments—we made cash investments in capital of over $105 million in 1990 and $75 million in 1991. Most of these capital expenditures related to hardware and software needed to keep Apollo technologically competitive.

In view of Covia's declining profitability and massive ongoing capital requirements, we obviously do not think the booking fees Covia charges are too high. Our current per transaction fees range from 20 cents to $1.30 depending on the type of transaction, and there are many kinds of transactions (such as checking a fare) for which we do not charge a fee. In view of their value to airlines, we believe Apollo services are, if anything, substantially underpriced.

Those who allege that Apollo booking fees are too high often cite the conclusion of the DOT's 1988 CRS study that, as of 1986, the booking fee for Apollo was 1.9 times the estimated average cost to provide the services. This study based its conclusions on data that are now more than 5 years old, and, among other things, it arbitrarily allocated CRS costs between airlines and travel agents in arriving at its conclusions. The conclusion about the Apollo booking fee reached in the study does not even remotely resemble reality for Covia. The reality is based on Covia's audited financial statements, not on outdated calculations from theoretical models based on arbitrary cost allocations.

In general, CRS booking fees are likely to be artificially low because the airlines that own CRSs themselves pay these fees and therefore are less inclined to institute increases than they otherwise might be. Because of the trend toward diversification of CRS ownership, almost all CRS owners now pay out more in booking fees than they receive. Indeed, the reason no new non-airline entrants have come into the CRS business is that they do not believe they can make a reasonable profit with booking fees at today's artificially low levels.

CRS fees also are a whopping bargain compared with booking fees in other businesses. Fees for even simple transactions such as Ticketron and Telecharge are a far greater percentage of the average ticket cost than the CRS booking fee, despite the fact that the CRS fee covers a far more complicated transaction.[16]

CRS fees are clearly not responsible for higher airfares. In exchange for the fees they pay, participating airlines receive many valuable distribution services—services they otherwise would be required to provide themselves. Moreover, booking fees typically represent less than one-half of one percent of the operating costs of an airline. This last fact, perhaps more than any other, demonstrates that CRS booking fees could not possibly be the source of the financial woes of the domestic airline industry.

2. The Proposed Arbitration Procedure

Because booking fees are not at supracompetitive levels, there is no need for a fee arbitration mechanism. Moreover, Covia agrees with Assistant Secretary Shane's comments before the House Aviation Subcommittee last year that arbitration procedures of the sort proposed here would be time consuming, costly, and ultimately unworkable. Particularly in view of the declining profitability Covia has experienced, arbitration would be a pointless exercise.

Moreover, the proposal is bad policy. While it is described as arbitration, the process would essentially be a ratemaking proceeding to establish utility pricing. A rate regulation scheme also creates an incentive for CRSs to be inefficient. Such a scheme will permit CRS vendors with the highest costs to charge the highest prices.

In addition, it does not make sense to single out for special treatment CRS fees, which constitute such a tiny percentage of airline costs. No one is proposing that other, far more significant, airline cost items—fuel, equipment, meals, and so on—

[16] Ticketron and Teleticket charge booking fees of $3.00 for the sale of a concert or theater ticket whose face value is usually under $50.00. Average Ticketmaster charges are around $2.50 per ticket and may be as high as $6.50 for a $25.00 ticket. Emshwiller, "Ticketmaster's Dominance Sparks Fears," Wall Street Journal, June 19, 1991, pp. B1, B2.

be subject to a cumbersome arbitration procedure. Like other airline cost items, CRS fees should be determined by the marketplace.

The arbitration mechanism outlined in S. 2312 would threaten Covia's very existence as a stand-alone company. Under the proposal, supposed incremental air transportation revenue will be treated as CRS revenue, thereby decreasing the amount that CRSs will be allowed to collect in the form of booking fees. As explained above, however, Covia is an independent CRS company, not an airline. The only CRS revenues Covia collects are booking tees from participating carriers and lease fees from travel agents (although the latter line of revenue is disappearing rapidly as a result of intense competition and may not exist next year). If hypothetical incremental revenue figures were credited in an arbitration proceeding, it would be financially impossible for Covia to operate as a stand-alone CRS business.

D. Overall Effects of the Legislation

Covia is particularly concerned that S. 2312 is likely to have a negative impact on technological innovation in the CRS business. If the legislation were enacted, CRS vendors might be unable to assure themselves that they would earn sufficient revenues to permit them to maintain and enhance their systems. The proposed prohibitions on contract terms would increase vendors' uncertainty regarding future revenues. And the intent of the arbitration provisions appears to be to put substantial downward pressure on booking fees. In such an environment vendors would be hesitant to make the very significant investments in technological innovation that have been the lifeblood of this high tech business. In addition, any government-imposed and monitored requirement of "multi-access" raises all of the dangers of technology regulation. Here there is a real threat that CRS vendors will be pushed into a lowest common denominator level of technology and that future development will be frozen at that level.

Ultimately, the proposed legislation is likely to have a particularly perverse effect. Covia operates now as a standalone business, supported by the CRS revenues it generates and independent of subsidies from its airline owners. To the extent the proposals deprive CRSs of the revenues they need to maintain state-of-the-art systems, Covia and other CRSs will be unable to survive as independent entities and will be driven back into the arms of the airlines—just the opposite of what we understood to be the sponsors' objectives.

Finally, the proposed legislation is virtually certain to raise costs for airlines, travel agents, and air transportation consumers. The sponsors of this legislation say they are concerned that CRS costs are too high, but several features of the legislation are virtually guaranteed to drive up costs. Mandating availability of "multi-access" would require CRS vendors to spend millions of dollars on what would ultimately be an inferior system for which there is little travel agent demand. Most of these costs would have to be passed on, and consumers would end up paying higher prices for air transportation. In addition, restricting the ability of CRS vendors to assure themselves of a reliable stream of revenues from usage by subscribers will inevitably mean that travel agents will no longer benefit from the extraordinarily low automation prices they have enjoyed in recent years.

The sponsors of the legislation cannot have it both ways. If they want to avoid large increases in CRS costs, they cannot impose expensive technological requirements and inefficient business arrangements. If they want to maintain the vigorous technical innovation that has prevailed in the CRS business, and promote the ability of CRSs to operate on a stand-alone basis, independent of their airline owners, they must allow free market principles to govern.

We urge the Subcommittee not to take hasty action based on rhetoric and the urgings of some competitors who are out to improve only their own positions, but instead to consider the present day realities of the CRS business. As Assistant Secretary Shane noted in his testimony before the House Aviation Subcommittee last year, regulation is inappropriate unless there is compelling evidence that the market is not functioning properly. There is no such evidence here, certainly not in the case of Covia. Moreover, there is a great danger that these proposals would do affirmative harm to a vigorously competitive and innovative high tech business.

We would be pleased to respond to questions from the Subcommittee. In addition, as noted above, we would welcome an opportunity to meet with the Subcommittee and its staff to answer questions and to demonstrate the capabilities the Apollo system offers for all participating carriers.

PREPARED STATEMENT OF ELLEN M. BOZMAN, CHAIRMAN, ARLINGTON COUNTY BOARD

On behalf of the Arlington County Board, I would like to thank you for this opportunity to express our views on the matter before the Subcommittee today. Our com-

ments are directed at the provisions of Senate Bill S. 2312 and its companion Bill in the House, H.R. 3620, that would reallocate slots at High Density Traffic Airports by allowing "new entrants" or "limited incumbents" to use commuter slots as air-carrier slots.

Arlington opposes any increase in air-carrier slot usage because of its impact on National Airport, which is one of the four High Density Traffic Airports subject to slot regulation. Our concern with this issue was communicated to you this past March, when we sent individual letters to Subcommittee members and the chairman of the Full Committee spelling out in detail the statutory, operational and environmental bases peculiar to slot restrictions at National Airport. A copy of this letter is attached.

As required by the "Aviation Safety and Capacity Expansion Act of 1990, the FAA is in the process of a rulemaking to promote the availability of slots at High Density Traffic Airports for "new entrant" or "limited incumbent" carriers. This rulemaking (Docket No. 25758) is nearing completion and specifically addresses the issue of access to slots at High Density Airports. To legislate a change in slot regulations in advance of this rulemaking, which should be complete in three months, is premature, and denies Congress the benefit of FAA expertise in responding to the issue.

A key component of this rulemaking is a revision of the "use or lose" provision of the existing regulations to increase the slot usage requirement from 65 percent to 90 percent. Increasing the slot usage requirement is a practical way to free up slots within the existing pool of slot reservations, which could then be allocated to "new entrant" or "limited incumbent" carriers. Experience at National Airport has shown that air-carrier slots become "unreserved" each year due to their usage falling below the current 65 percent "use or lose" requirement. However, these slots rarely become available for "new entrant" or "limited incumbent" air carriers because the usage requirement is sufficiently low to enable their owners to reestablish reserved status with only minor schedule adjustments, and there is no mechanism for establishing a "protected" class of air carriers which have special status in slot availability. Increasing the "use or lose" requirement to 85 percent, for example, can realistically be expected to free up slots from within the pool of available air-carrier slots at National Airport. This tightened standard, when combined with a directed-availability of "unreserved" slots to "new entrant" or "limited incumbent" air carriers, holds great promise to resolve the competitive access issue articulated in S. 2312 and H.R. 3620. The 85 percent requirement is recommended over the 90 percent figure contained in the FAA rulemaking because it 'provides flexibility for air carriers to make minor schedule adjustments in response to equipment availability and travel demand, without jeopardizing the "reserved" status of the slots.

Experience has also shown that air carrier slots become available from time to time through changes in service patterns by the "established" air carriers. The most recent example is Northwest Airlines' withdrawal of 18 departures (36 slots) at National Airport, effective this June. We understand that twenty-eight of these slots have been leased by USAir, leaving eight slots uncommitted.

The unavoidable consequence of the approach proposed in the current bills (S. 2312 and H.R. 3620) is to increase the burden of noise on communities in the vicinity of both the originating and destination airports. The use of former "commuter" slots as "air carrier" slots will change the type of aircraft in use, substituting large, turbojet aircraft for smaller turboprop or turbojet aircraft. Turbojet aircraft produce considerably more noise than turboprop aircraft and large turbojets produce more noise than smaller turbojets. The noise consequences of this change in the permitted fleet mix are obvious.

An additional concern with the proposed slot reallocation is its effect on air service to communities now served by commuter air carriers. At National Airport, the predominance of communities served by commuter carriers are not served by the scheduled air carriers. Allowing commuter slots to be used as air-carrier slots can be expected to produce a raid on commuter slots because of the greatly increased value of such slots to the air carriers. There is every likelihood that smaller communities now served by commuter carriers will lose service to air carriers serving larger markets. The loss of such service is a perversion of the market that should not be encouraged. The perversion would be further compounded if such service was restored through the "Essential Air Service" provisions, which involve federal subsidy, and which, by the terms of the proposed bill, would not be accountable under the slot provisions of the High Density Rule.

As we stated in our letter to you last March, we do not object to constructive approaches to improving access to High Density Traffic Airports for new air carriers or existing air carriers wishing to expand service. We believe the FAA rulemaking underway is a constructive approach, offering a workable solution to the problem

without the adverse consequences clearly associated with the proposed bills. The FAA rulemaking should be allowed to come to closure and its approach implemented and evaluated before any new legislative solution is pursued.

LETTER FROM ELLEN M. BOZMAN, CHAIRMAN, ARLINGTON COUNTY BOARD

MARCH 25, 1992.

The Honorable WENDELL H. FORD,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR FORD: We understand you have in your Committee a bill known as the "Airline Competition enhancement Act of 1992" which proposes to alter the allocation of flight reservations (slots) at High Density Traffic Airports. As the host jurisdiction for National Airport, we have an abiding interest in any change affecting flight operations, and are communicating with you in advance of your deliberations on the bill.

House Bill H.R. 3620 and its companion bill in the Senate, S. 2312, would make additional air-carrier slots available from within the total pool of slots. By allowing "new entrant" and "limited incumbent" airlines to acquire slots at High Density Airports now reserved for commuter airline service, these bills: 1) increase the number of allowable hourly and daily flight operations by air carriers; and 2) substitute large turbojet aircraft for smaller turbojet or propeller aircraft.

The retention of the 37-per-hour slot reservation for air carrier operations was essential to our support of the interstate compact that permitted the transfer of National Airport from the federal government to the Metropolitan Washington Airports Authority. The fact that this restriction on air-carrier operations at National Airport was made an integral part of the transfer legislation underscores the importance of operational limits. As a point of reference, attached is a list of the "milestone" events that have established the status quo for slots and their allocation at National Airport.

The Arlington County Board is opposed to any increase in air-carrier operations at National Airport. The current bills, by allowing increased flights of large turbojet aircraft, would impose more noise on the surrounding communities than is presently the case, and would undermine future noise abatement gains promised by the Airports Authority in its Part 150 Noise Compatibility Plan which was submitted to the Federal Aviation Administration (FAA).

We understand the purpose of these bills is to improve access to High Density Traffic Airports for new air carriers or existing air carriers wishing to expand service, and we do not object to this goal. However, we do object strongly to any mechanism that increases the noise impacts of air-carrier flight operations, and the two bills, because they do not exempt National Airport, are clearly in that category. In our view, the access issue must not be addressed at the expense of the hard-won gains on the noise issue which have been agreed to by the Congress, the FAA, the Commonwealth of Virginia, the District of Columbia, and the Airports Authority.

We urge you to give these comments your most careful attention in your consideration of these bills.

Sincerely,

ELLEN M. BOZMAN,
Chairman.

ATTACHMENT

The Metropolitan Washington Airports Policy adopted by the Federal Aviation Administration (FAA) in 1981 specifically recognized the Department of Transportation's (DOT) objective of "reducing aircraft noise and congestion associated with the prevailing use of Washington National." With regard to slots, this Policy reduced by three the number of hourly air-carrier operations at National Airport (to a maximum of 37 from the previous 40). To quote the FAA, "The reduction of air-carrier hourly slots * * * will give relief from noise and groundside congestion." The Policy also addressed the hourly allocation of operations among different classes of users at National Airport, while holding constant the total hourly slots divided among air-carrier, commuter airline, and general aviation flight operations.

A proposal to increase the air-carrier portion of the available hourly slot pool at National Airport from 37 to up to 43 was considered by the FAA in 1984. In rejecting this proposal, the DOT and FAA reached two conclusions that bear repeating at this time: 1) reducing the number of flights by larger turbojet aircraft reduces

noise impacts; and 2) increasing the number of allowable daily operations is inconsistent with the FAA objective of reducing aircraft noise and congestion at National Airport.

The status of National as a "High Density Traffic Airport" subject to the "High Density Rule" is recognized in the Metropolitan Washington Airports Act of 1986 which permitted the transfer of the operating authority from the federal government to the Metropolitan Washington Airports Authority. Section 6009., Subsection (e)1. of the Act precludes the FAA from making changes to the High Density Rule at National Airport, stating "The Administrator may not increase the number of instrument flight rule takeoffs and landings authorized for air carriers by the High Density Rule (14 C.F.R. 93.121 et seq.) at Washington National Airport on the date of enactment of this title and may not decrease the number of such takeoffs and landings except for reasons of safety." The Act applies this same prohibition to the Airports Authority in Section 6005., Subsection (c)5.(c), which states "The Airports Authority may not increase or decrease the number of instrument flight rule takeoffs and landings authorized by the High Density Rule (14 C.F.R. 93.121 et seq.) at Washington National Airport on the date of the enactment of this Act. * * *"

The High Density Rule, as applied by the FAA to National Airport, establishes a precise allocation of flight reservations (slots) between different classes of users—air-carriers, commuter airlines, and general aviation. This being the case, any proposal to shift slots from one category to another is in violation of the Rule, even though the overall number of slots remains fixed.

The PART 150 Noise Compatibility Plan prepared by the Airports Authority and submitted to the FAA in the fall of 1991 relies on the allocation of flight reservations for air-carrier operations established by the slot rule at National Airport. Any increase in the number of air-carrier flights during the 15-hour period subject to slot regulations will undercut the entire premise of the noise abatement effort, which uses the fixed number of flight operations in combination with a projected increase in the proportion of Stage III aircraft in the air-carrier fleet mix at National Airport to offer measurable improvement in the noise environment.

LETTER FROM JAMES E. NATHANSON, VICE CHAIRMAN, COMMITTEE ON NOISE ABATEMENT AT NATIONAL AND DULLES AIRPORTS

JUNE 8, 1992.

Honorable WENDELL H. FORD,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR FORD: I am writing to reiterate the Metropolitan Washington Council of Governments' opposition to changes to the existing slot rule at National Airport. Our position (attached) has been stated to the Subcommittee during previous legislative deliberations concerning slot rule changes at National Airport, and is re-submitted for the record.

The key issues raised in the attached correspondence are:

- Local governments of the Washington Area have an abiding interest in maintaining the existing statutory limit of 37 commercial air carrier slots at Washington National Airport.
- The slot and high density rules were pivotal to the political consensus among federal, state, regional and local interests in formulating the legislation that transferred National and Dulles Airports to the Metropolitan Washington Airports Authority.
- There are safety and level of service concerns that underlie National's slot rule that were reflected in the FAA's action in imposing the rule originally in 1976. These concerns should not simply be erased by statute.
- The current slot rule underlies airport master planning, regional airport facilities planning, "Part 150" noise mitigation planning and capital improvements programming affecting National Airport. The Airports Authority itself strongly favors retention of the existing slot rule at National.
- The frequency of noise incursion by aircraft is as important as the level of noise itself.

I thank you for the opportunity to restate the Council of Governments' position on this very important regional issue.

JAMES E. NATHANSON.

LETTER FROM MARY MARGARET WHIPPLE, CHAIR, COMMITTEE ON NOISE ABATEMENT AT NATIONAL AND DULLES AIRPORTS

MARCH 18, 1992.

Honorable WENDELL H. FORD,
U.S. Senate,
Washington, DC 20510

DEAR CHAIRMAN FORD: I want to reiterate the Metropolitan Washington Council of Governments' position on S. 2312, the "Airline Competition Equity Act of 1992." It is firm policy of the Metropolitan Washington Council of Governments (COG) and its Committee on Noise Abatement at National and Dulles (CONANDA) to oppose legislative initiatives that would alter the existing 37 commercial flights per hour limitation at National Airport.

We should point out at this juncture that COG and CONANDA are not responding to the merits of these portions of the pending bill that would propose prohibitions against vendor discrimination with regard to computer reservation systems and protection of small community airline passenger service. Our policies only address the part of the legislation concerning increasing the number of slots allocated to commercial flights.

We know that the transfer of commuter slots to the use of commercial aircraft service will have a negative noise impact on the residents in this region. The local governments in COG have an abiding interest in maintaining the existing statutory limit of 37 commercial air carrier operations at Washington National Airport.

This bill would alter this policy; if enacted it would breach the solemn promises on which the legislation transferring National and Dulles Airports to the Metropolitan Washington Airports Authority (MWAA) was founded. And as you are aware, it would undermine the original basis for the slot rule at National Airport. The premise for the slot limitation was to limit commercial operations and, thereby reduce some of the onerous noise burden on affected communities in our region. The preservation of the slot rule is an essential part of these solemn commitments that were made leading up to the development of the transfer legislation commitments that made the legislation politically acceptable to the local governments of the Washington region.

I am enclosing for the record more detailed correspondence on this issue which addresses our concerns. Please note that this correspondence is related to similar legislative attempts in 1990 and 1991.

In closing,, we request that COG and the affected local governments in the region be given the opportunity to fully participate in the hearing process on this bill or any other legislation before your Committee that provides for alteration of the slot policy at National Airport.

Please accept my thanks for being given the opportunity to express our views on this critically important issue.

Sincerely,

MARY MARGARET WHIPPLE,
Chair, CONANDA.

LETTER FROM MARY MARGARET WHIPPLE, CHAIR, COMMITTEE ON NOISE ABATEMENT AT NATIONAL AND DULLES AIRPORTS

NOVEMBER 27, 1991.

Honorable WENDELL H. FORD,
U.S. Senate,
Washington, DC 20510

DEAR CHAIRMAN FORD: I am writing to you in my capacity as the Chair of the Council of Governments Committee on Noise Abatement at National and Dulles Airports (CONANDA), and I am requesting that Washington National Airport be exempted from S. 1628. The reasons for this request is explained in detail in the body of this letter.

S. 1628 has two main features. It would prohibit the purchase, sale or lease of "slots" by commercial air carriers on or after August 1, 1991. The second objective is the provision of additional slots for new entrant carriers at High Density Rule airports. The Federal Aviation Administrator would be required to make a rule establishing a pool of slots for such carriers within 60 days of enactment of the legislation. This new policy would permit up to a 5 percent increase over existing slots and would terminate the High Density Rule completely 18 months after of enactment. Finally, of most importance to the Washington metropolitan region, the bill

would amend the Metropolitan Washington Airports Act of 1986 to accommodate this new policy.

The local governments in COG have an abiding interest in maintaining the existing statutory limit of 37 commercial air carrier operations at Washington National Airport. This bill would change this policy; if enacted it would breach the solemn promises on which the legislation transferring National and Dulles Airports to the Metropolitan Washington Airports Authority (MWAA) was founded.

A short historical perspective might best establish why we have strong objection to that part of the bill that would alter this operational level at National.

I realize it is no surprise to you and your colleagues on the Subcommittee that the local governments adjacent to National and those impacted by its flight patterns have long sought to control commercial operations there. But, individually and as a metropolitan community, we have attempted to be constructive in these efforts. To this end, we supported through COG, the undertaking of airport systems planning for the three commercial facilities that service the Washington region - National, Dulles and Baltimore-Washington International Airports. This systems planning has been done for approximately 15 years with planning grants supported by the Federal Aviation Administration (FAA). It has supplied federal, state and local officials much of the information and alternative development choices for meeting the air transportation needs of both the Washington and Baltimore regions. Most relevant here, however, these planning efforts clearly established that National Airport could and should have operational limits, and more emphasis should be placed on expanding facilities and operations at Dulles and BWI.

Moreover, the need to reduce, or at the very least, stabilize the growth of operations at National were verified in cooperative efforts by COG and the FAA to examine options to curtail noise at National and later, by COG's Committee on Noise Abatement at National and Dulles Airports (CONANDA). CONANDA is recognized by MWAA as the official regional advisory body on noise reduction matters.

These system and noise abatement planning efforts manifested themselves in the evolution of FAA policy on National which, among other things, established operational limits on the number of commercial operations per hour and passenger caps at National. The slot limit at National, therefore, predated the imposition of the high density rule and its origin was based on traffic management.

In short, the slot rule as applied to National has been an effective tool for managing operations at the Airport; it has provided a significant deterrent to unbridled growth. Accordingly, this rule was pivotal to the consensus among federal, state, regional, and local interests in formulating the legislation that transferred National and Dulles to MWAA. As you know, it was so vital to the accord that it was written into the transfer legislation approved by your Subcommittee and enacted by Congress. I believed this commitment was indelible. It represented a balancing of interests and led to a viable compromise.

The level of operations permitted under the rule was larger than we preferred, especially in view of the legislative repeal in the transfer Act of the FAA rule that put a passenger cap at National. But, it did establish strictures on operations in prime travel times, and further provided the MWAA with the statutory authority for restricting operations during late night hours.

A compromise usually does not please everyone. In such negotiations, one must forego some special interests to achieve what is in the general interest. I also believe fairness requires that the rule should not be changed afterward. Therefore, S. 1628 should not be enacted without exempting National Airport from the scope of its application.

Finally, Mr. Chairman, I have already indicated the intense interest COG and its noise committee have in finding ways to reduce noise at National. We are seeking solutions that recognize National as an integral part of the airport system that serves the National Capital region. It has been a difficult challenge to find ways to serve the disparate interests in the community, but we have made some progress, and working cooperatively with MWAA we intend to make much more. Unfortunately, this bill would thwart these efforts. If one thing has become clear in our noise reduction activities it is this single fact. The frequency of the noise incursion is an important as the level of the noise itself. Thus, more slots equate to more noise. And, the impacted segments of our regional community have said over and over again, "enough is enough!"

In closing, Mr. Chairman, please accept my thanks for being given the opportunity to express our views on this critically important issue.

Sincerely,

MARY MARGARET WHIPPLE,
Chair, CONANDA.

LETTER FROM BETTY ANN KANE, CHAIR, COMMITTEE ON NOISE ABATEMENT AT NATIONAL AND DULLES AIRPORTS, AND JAMES P. MORAN, MEMBER, COUNCIL OF GOVERNMENTS

JULY 18, 1990.

Honorable WENDELL H. FORD,
U.S. Senate,
Washington, DC 20510

DEAR CHAIRMAN FORD: We are writing to you in our capacities as the Chair of the Board of Directors of the Metropolitan Washington Council of Governments (COG), and Chair of the COG Committee on Noise Abatement at National and Dulles Airports (CONANDA), and Mayor of the City of Alexandria and member of the COG Board, concerning the referenced pending bill before your Subcommittee.

S. 2851 has two main features. It would prohibit the purchase, sale or lease of operating rights or "slots" by commercial air carriers subsequent to July 12, 1990. The second objective is the provision of additional slots for new entrant carriers at High Density Rule airports. The Federal Aviation Administrator would be required to make a rule establishing a pool of slots for such carriers within 60 days of enactment of the legislation. This new policy would permit up to a 5 percent increase over existing slots and would terminate the High Density Rule completely 18 months after of enactment. Finally, of most importance to the Washington metropolitan region, the bill would amend the Metropolitan Washington Airports Act of 1986 to accommodate this new policy.

The local governments in COG have an abiding interest in maintaining the existing statutory limit of 37 commercial air carrier operations at Washington National Airport. The Senators' bill would change this policy;. if enacted it would breach the solemn promises on which the legislation transferring National and Dulles Airports to the Metropolitan Washington Airports Authority (MWAA) was founded.

A short historical perspective might best establish why we have such strong objection to that part of the bill that would alter this operational level at National.

We realize it is no surprise to you and your colleagues on the Subcommittee that the local governments adjacent to National and those impacted by its flight patterns have long sought to curtail commercial operations there. But, individually end as a metropolitan community, we have attempted to be constructive in these efforts. To this end, we supported through COG, the undertaking of airport systems planning for the three commercial facilities that service the Washington region—National, Dulles and Baltimore-Washington International Airports. This systems planning has been done for approximately 15 years with planning grants supported from the Federal Aviation Administration (FAA). It has supplied federal, state and local officials much of the information and alternative development choices for meeting the air transportation needs of both the Washington and.Baltimore regions. Most relevant here, however, these planning efforts clearly established that National Airport could and should have operational limits, and more emphasis. should be placed on expanding facilities and operations at Dulles and BWI.

Moreover, the need to reduce or at the very least stabilize the growth of Operations at National were verified in cooperative efforts by COG and the FAA to examine options to curtail noise at National and later, by COG's Committee on Noise Abatement at National and Dulles Airports (CONANDA). CONANDA is recognized by MWAA as the official regional advisory body on noise reduction matters.

These system and noise abatement planning efforts manifested themselves in the evolution of FAA policy on National which, among other things, established operational limits on the number of commercial operations per hour and passenger stops at National. The slot limit at National, therefore, predated the imposition of the high density rule and its origin was based on traffic management.

In short, the slot rule as applied to National has been deemed a surrogate for managing operations at the Airport; it provided a significant deterrent to unbridled growth. Accordingly, this rule was pivotal to the consensus among federal, state, regional, and local interests in formulating the legislation that transferred National and Dulles to MWAA. As you know, it was so vital to the accord that it was written into the transfer legislation approved by your Subcommittee and enacted by Congress. We believed this commitment was indelible. It represented a balancing of interests and led to a viable compromise.

The level of operations permitted under the rule was larger than we preferred, especially in view of the legislative repeal in the transfer Act of the FAA rule that put a passenger cap at National. But, it did establish structures on operations in prime travel times, and further provided the MWAA with the statutory authority for restricting operations during late night hours.

A compromise usually does not please everyone. In such negotiations, one must forego some special interests to achieve what is in the general interest. We also believe fairness requires that the rules should not be changed afterward. Therefore, S. 2581 should not be enacted without exempting National Airport from the ambit of its operations.

One final point, Mr. Chairman, we have already indicated the intense interest COG and its noise committee have in finding ways to reduce noise at National. We are seeking solutions that recognize National as an integral part of the airport system that serves the National Capital region. It has been a difficult challenge to find ways to serve the disparate interests in the community, but we have made some progress, and working cooperatively with MWAA we intend to make much more. Unfortunately, this bill would thwart these efforts. If one thing has become clear in our noise reduction activities it is this single fact. The frequency of the noise incursion is as important as the level of the noise itself. Thus, more slots equate to more noise. And; the impacted segments of our regional community have said over and over again, "enough is enough!"

In closing, Mr. Chairman, please accept our thanks for being given the opportunity to address our views on this critically important issue.

Sincerely,

BETTY ANN KANE,
Chair, CONANDA.
JAMES P. MORAN,
Member, COG Board of Directors.

LETTER FROM MARY MARGARET WHIPPLE, CHAIR, COMMITTEE ON NOISE ABATEMENT AT NATIONAL AND DULLES AIRPORTS

NOVEMBER 15, 1991.

The Honorable CHARLES S. ROBB,
U.S. Senate,
Washington, DC 20510

DEAR SENATOR ROBB: It has come to my attention that there is an effort underway in the Senate and House to severely weaken or eliminate the slot rule at Washington National Airport by attaching language to legislation being written to correct the Constitutional deficiencies in the 1986 airports transfer legislation.

I view this with great alarm and ask that you assist us by preventing any change in the long standing slot limitations at National Airport.

First, the existing slot rule of 37/hr. air carrier operations and 60/hr. total operations at National was pivotal to the political consensus among federal, state and local interests in forging the legislation that transferred operation of National and Dulles Airports to the Metropolitan Washington Airports Authority. I believe there has been general satisfaction with the conditions of the transfer that ultimately occurred and which localities would like to see retained. The local governments of the Washington area view the slot rule as an inviolable part of the contract between the federal, state, and local levels of government and believe the slot rule is critical to the continued environmental acceptability of this centrally located airport. It is singularly inappropriate that this consensus might be overturned by parties who will not bear the environmental and service consequences of changing the rules on slots.

Secondly, in my opinion, there are safety and level of service concerns that also underlie National's slot rule that were reflected in the FAA's action in imposing the rule originally in 1976. These concerns should not simply be erased by statute.

Thirdly, the current slot rule underlies airport master planning, regional airport facilities planning, "Part 150" noise mitigation planning and capital improvement programming affecting National Airport. The Committee on Noise Abatement at National and Dulles Airports at COG takes issue with the assumption that there is sufficient airspace and groundside capacity to absorb additional slots at National, not to mention the unacceptability of further noise intrusions that would result. I should add that the Airports Authority itself strongly favors retention of the existing slot rules at National.

Finally, I am concerned about the haste and lack of full legislative procedure that seems to accompany important federal policies bearing upon airport noise' issues, the most notable example being last year's Airport Noise and Capacity Act, the de minimis notice given to interested parties regarding subsequent FAA rulemaking, and now, a possible attempt to inject the slot issue into the airports transfer corrective legislation.

Should you desire further background information on CONANDA's position on the National Airport slot rule, please call Mr. Trevis Markle, Assistant Director, Department of Environmental Programs.

Again, we ask for your help and that you work with your colleagues in the Washington area's Congressional Delegation to prevent any legislative or regulatory tampering with the existing slot rules at National Airport.

Sincerely,

MARY MARGARET WHIPPLE,
Chair, CONANDA.

LETTER FROM GREGORY A. CONLEY, VICE PRESIDENT AND GENERAL COUNSEL, COVIA

JUNE 24, 1992.

Honorable WENDELL FORD,
U.S. Senate,
Washington, DC 20510

DEAR CHAIRMAN FORD: I listened with great interest to the testimony of Northwest Airlines' spokesman at the June 10 hearing before your Subcommittee. Two assertions made by Northwest's spokesman were particularly false and misleading. For the record, I have provided you below with the correct information.

First, in response to your question regarding the number of owners of the company to be created by the merger of Covia and Galileo, the Northwest spokesman said (and confirmed again after you questioned his response) that this company would have no owners in addition to Covia's current 7 owners. This is false. The new company resulting from the merger will have at least 10 owners.

Second, the Northwest spokesman asserted that due to supposed advantages arising from being a hosted carrier on Covia's Apollo CRS, United was uniquely able a match Northwest's "Adults Fly Free" promotional fares on May 26-27 in Apollo. This is false.

On the morning of May 27, Northwest was the only carrier for which those fares were displayed in Apollo. Between approximately 11:00 a.m. and Noon, United requested Covia to add in Apollo competitive United fares in approximately 187 markets. In accordance with Covia's contract with United, the United fares were made available via on-line changes to the Apollo database. This manual effort was completed by approximately 2:00 p.m. on May 27. This same basic service (Online Fare Updates) is offered by Covia to all participating carriers in Apollo, including, of course, Northwest. It is not unique to a hosted carrier.

Moreover, United was competitive with Northwest only by the afternoon of May 27, and even then in less than 200 markets (out of the approximately 17,000 total United markets that contained the fares on Thursday, May 28).

It is also important to note that initially United's fares, while available in a tariff display, did not contain any rule information. Apollo, therefore, was unable to automatically price these fares (i.e., the fares were displayable in the system, but the tickets had to be manually priced). The rules and remaining fares for United, and the other carriers that matched Northwest, were loaded at 6:56 a.m. Thursday, May 28 (somewhat later than normal due to the high volumes created by Northwest's fare action).

Rather than use Covia's online fare updating service, Northwest prefers to decline and instead mislead you and your Subcommittee into believing that this service is available only or a hosted carrier like United. This approach is consistent with Northwest's overall conduct of complaining of disparate treatment when it is Northwest, and not Covia, which is to blame. (Another example cited in Covia's written statement for the June 10 hearing is Northwest's refusal to participate in last seat availability in Apollo.) Northwest is pressing Congress for mandated changes in CRS functionality, yet it refuses to use the equal functionality that is already available in Apollo today. This more than anything demonstrates that Northwest's true purpose is to seek competitive advantage, not equal functionality, through legislation.

I hope the foregoing sets the record straight on these matters. If you, your staff or any other member of the Subcommittee or their staff would like any further information, I would be happy to provide it.

Thank you for your consideration.

Sincerely,

GREGORY A. CONLEY,
Vice President and General Counsel.

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